A.T. & T. PROPOSED SETTLEMENT

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

A.T. & T. PROPOSED SETTLEMENT

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A.T. & T. PROPOSED SETTLEMENT

THURSDAY, MARCH 25, 1982

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Reno, Nev.

The committee met, pursuant to notice, at 9:30 a.m., in City Council chambers, City Hall, Reno, Nev., Hon. Howard W. Cannon presiding.

Staff members assigned to this hearing: Riley K. Temple, Staff Counsel, and Will K. Ris, Minority Staff Counsel.

OPENING STATEMENT BY SENATOR CANNON

Senator CANNON. The hearing will come to order.

Good morning. This hearing is a continuation of an ongoing inquiry by the Senate Commerce Committee into the potential effects of the proposed agreement between American Telephone & Telegraph and the Department of Justice that will lead to the divestiture of Bell's local operating companies.

This proposed settlement is one of particular concern to Nevada for a number of reasons. First, the economy of the State is highly dependent upon efficient and reasonably priced telephone and data services. In particular, our tourism industry is one of the largest and most sophisticated users of long distance communications in the Nation. Accordingly, one of the most important aspects of the hearing will be to consider whether the new competitive environment envisioned by the proposed settlement will be a plus or a minus for the State's largest industry.

A second major concern is that Nevada has some of the most isolated and inaccessible communities served by telephone anywhere in the country. Hence, the impact of proposed settlement on rural telecommunications will be a major focus.

The third important and unique concern is the potential impact upon the telephone users in Reno. Our concern about this point is unique, because Nevada Bell is the smallest of the local operating companies in the Bell System. As such, it is potentially the most vulnerable to any problems that might beset local telephone companies as a result of the divestiture.

I am particularly concerned about this point, because A.T. & T. has announced its intention to spin off Nevada Bell into a single holding company together with Pacific Telephone. It is no secret that Pacific Tel is currently the weakest link in the Bell System. Whatever the cause of Pacific Telephone's financial problems, it is imperative that telephone users in Nevada not be penalized by what is happening in California, and in no case should the ratepayers in Nevada be subsidizing telephone users in California.

I want to explore this issue in some detail later this morning. Meanwhile, I am hopeful that we will be reassured today about the viability of both Pacific Tel and Nevada Bell. I am encouraged that the announced plan would make Nevada Bell a completely separate operating entity. I am sure that we will be hearing from the Bell witnesses on this point.

Let me briefly outline some of the other concerns that will be addressed this morning. What will be the impact on other telephone companies outside the Bell System, in particular Centel and the smaller independents operating in Nevada? What will be the effect of the settlement on local rates and services in Nevada, both within and outside of the Bell System? How will long distance services and prices be affected? What will be the impact in Nevada and elsewhere on those companies who compete with the Bell System in providing services and manufacturing equipment?

As you can see, this is ambitious agenda. The Commerce Committee has already covered such important additional areas as the potential impact upon national defense, international trade, balance of payments, and other major issues. All of these factors are of major concern to Congress in evaluating the public interest in the proposed settlement and determining the desirability of legislation.

Now, I would like to conduct this hearing in a different manner than we usually do. Because all the witnesses are highly qualified, and each represents a unique point of view, I would like to encourage as much discussion and debate as possible. Thus, I would like to wait until the conclusion of all the formal presentations before getting to the questions. During the question period, I would encourage a free flow of ideas from all the parties.

Some of our witnesses have come a long way to attend this hearing, and have early afternoon flights to catch. We will certainly try to accommodate your schedules. The best way to do this is to keep the formal statements very brief. Please, no more than 5 minutes each at the most. Let us save the limited time we have for discussion. Your full statements will all be made a part of the record.

The order of the hearing will be as follows. We will start with the formal statements of the Bell witnesses. Then we will follow with the statements of Central and Lincoln County Telephone. Then we will hear the statements from Lynch, Executone, and Southern Pacific, and finally, we will close with the statements of the Public Service Commission and the Consumer Advocate.

I will see that the hearing record is kept open for 2 weeks in order to allow the opportunity for any other interested parties to submit testimony or react to anything that you hear today.

I wonder if we could have everyone identify themselves now for the record, for the reporter, as we go around, just starting right here on my left.

Mr. HOLMES. John Holmes, Nevada Public Service Commission.

Mr. KUSHAN. Jeff Kushman.

Mr. VANALLEN. Dick VanAllen, Nevada Bell.

Mr. GUINN. Don Guinn, Pacific Telephone and Nevada Bell.

Mr. DEBOIS. Jim DeBois, A.T. & T. Co.

Mr. **McGee**. Marvin McGee from Lynch Communications.

Mr. **Smith**. Bill Smith, Executone Systems of Nevada.

Mr. **Christian**. John Christian, Lincoln County Telephone.

Mr. **McGrew**. Bill McGrew, Central Telephone Co., Las Vegas.

Mr. **Wellinghoff**. Jon Wellinghoff, Office of Consumer Advocate.

Senator **Cannon**. All right. I think we have everyone there. We will start off with Mr. James DeBois, associate general counsel, American Tel and Tel, Basking Ridge, N.J.

STATEMENT OF JAMES DeBOIS, ASSOCIATE GENERAL COUNSEL, AMERICAN TELEPHONE & TELEGRAPH

Mr. **DeBois**. My name is James A. DeBois. I am associate general counsel of the A.T. & T. Co.

I welcome the opportunity to appear before you to discuss the agreement reached between the Department of Justice and the A.T. & T. Co., which modifies the 1956 consent decree. The 1982 final judgment is, as I said, a modification of the 1956 decree, and it provides that the A.T. & T. Co. will divest the local-exchange operations of 22 Bell operating companies, which I will refer to as BOC's as I proceed through this brief statement.

These are the operations which permit customers to complete local calls and gain access to long-distance and international networks. Facilities involved in these operations represent approximately two-thirds of the Bell System's total plant or, to put it another way, over $80 billion in assets. The divested local exchange companies are required to provide equal access to their local services, to all interexchange carriers, and information service providers.

After the divestiture, ownership of customer premises equipment and the Western Electric manufacturing subsidiary and Bell Laboratories will remain part of the A.T. & T. Co. Also, all Bell System interstate long-distance facilities and a portion of the intrastate long-distance facilities now owned by the BOC's will be retained by the A.T. & T. Co.

The keystone of our agreement with the Department of Justice is the removal of the anticompetitive provisions of the 1956 consent decree which resolved a Government suit instituted in 1949. Both the 1956 consent decree and the proposed modification of that final judgment which was filed January 8, 1982, are pending before Judge Harold H. Greene, U.S. district judge for the District of Columbia.

Within 6 months of the effective date of the modification, that is, within 6 months of the date of entry of that order, A.T. & T. must submit to the Department of Justice for its approval a plan of reorganization that achieves the modification's objectives. A.T. & T. will have 18 months to implement the reorganization plan from the effective date of the proposed modification.

Whether or not the Antitrust Procedures and Penalties Act of 1974, the Tunney Act, technically applies to a modification of the 1956 consent decree, both parties, both the A.T. & T. Co. and the Department of Justice, have from the very start contemplated that hearings permitting public comment and judicial review would be held and should be held in Washington, D.C. Such proceedings are now underway before Judge Greene.

I would close my opening comments by simply saying that we have every confidence that Judge Greene will find the new decree to be in the public interest.

Thank you, sir.

Senator CANNON. Thank you very much, Mr. DeBois.

Next we will hear from Mr. Donald Guinn, chairman of the board, Pacific Tel & Tel.

STATEMENT OF DONALD E. GUINN, CHAIRMAN OF THE BOARD, PACIFIC TELEPHONE & TELEGRAPH CO.

Mr. GUINN. Thank you, Senator, and good morning.

I am Don Guinn, chairman of the board and chief executive officer of the Pacific Telephone & Telegraph Co. and the Bell Telephone Co. of Nevada.

I appreciate the opportunity you have given me to be here today, and to offer Pacific Telephone and Nevada Bell's perspective on the emerging national telecommunications policy in general and the effect of the proposed consent decree between the Bell System and the Department of Justice in particular.

You will notice that Mr. DeBois' opening statement was significantly less than 5 minutes. Mine will be a little bit longer, and we will average 5 minutes between the two of us.

Senator CANNON. All right. We will take that average.

Mr. GUINN. All right. Thank you.

In the next 5 minutes or so, then, I would like to comment on the effects of the decree on the quality and cost of services we offer the public, the jobs we provide our employees, and on Pacific and Nevada Bell's future service and earnings prospects. I intend to address our corporate situation. Then, Dick VanAllen, the vice president and general manager of Nevada, will speak more specifically about our activities in Nevada.

Let me begin with a few numbers that describe the scope of our business. We currently serve almost 17 million telephones in California and Nevada. Last year, more than 3 billion toll calls and almost 29 billion local calls were placed from these telephones. We have nearly 115,000 employees, and over 57,000 shareholders.

The question of the day seems to be how the various aspects of our business will be affected by the proposed consent decree. Let me begin with a question that has captured far more than its share of attention since the consent decree's announcement was made on January 8.

I am talking, of course, about the alleged upward pressure the decree is supposed to produce on local rates. True, rates are and will continue to go up, but from my point of view it is simply inaccurate to blame them on the consent decree. These increases are the result of inflation and competition. Ever since the telecommunications industry was opened up to competition by the FCC, rates have been moving toward their cost as a natural economic reaction. Consequently, cross-subsidies from long-distance that have historically kept local rates down have been reduced.

while telephone rates have undeniably gone up, their rate of increase has been far less than that of other basic items.

I feel confident in predicting that due to our continued commitment to careful expense controls, the introduction of cost-effective technology, and our determination to work effectively with our regulators to develop the pricing structure we need, future telephone rate increases will continue to make telephone service one of the best bargains in the marketplace.

Now, to the question of how our employees will fare under the decree. It is an issue that would concern me a great deal if I were not so sure of our ability to handle the situation. Put simply, the decree makes no change in employee benefits or pensions for either active or retired employees. It does not alter any existing bargaining agreements covering Bell employees.

Furthermore, Pacific Telephone and Nevada Bell have always been good places to work. After divestiture, that is not going to change. We are still going to need people with the same rich diversity of skills that we need today. In my judgment, Pacific and Nevada Bell people need not worry about future opportunities.

Next, I would like to comment on the company's future as it relates to both service offerings and earnings. I hope you will pardon me if I bristle somewhat at the characterization from some quarters that the local exchange business will be relegated to a cable and wire operation. If anyone takes the time to think about what we will have going for us, it does not take very long to come up with a pretty attractive list.

Already, we are beginning to think of ourselves less as a vendor of voice services and more as a conduit for information exchange, for information transfer is going to be our business, and voice will be but one component of this promising new business.

For example, many new and impressive entrepreneurs are entering the market with a wide array of new communications equipment to be located in homes and offices. They are selling such things as energy control systems, video text, and home computers. All these developments will dramatically increase the use of the local network. By constantly upgrading the capacity and sophistication of local exchange equipment, we will be able to participate fully in this expanding, dynamic marketplace.

Indeed, technological improvements, like Lightguide and cellular communications will continue to change the shape of our industry and vastly increase the scope of the services we can offer. In Nevada and California, we have one of the most modern, sophisticated telephone communications networks in the world. By the end of this year, 52 percent of our customers will be served by stored program controlled electronic switching systems, and that number is even higher, as Dick VanAllen will testify, for Nevada alone than it is for the company average.

We have an extensive digital trunking system between our central offices, and we are beginning to introduce Lightguide transmission systems. Cellular technology in the form of advanced mobile phone serivce will begin to be made available to our customers in the near future.

With the proper pricing strategy and a strong technological base, Pacific and Nevada Bell, I assure you, will leave no stone unturned

Then, too, competition has resulted in more rapid replacement of equipment which has in turn caused more rapid depreciation of some of our equipment and brought about an additional need for revenues. Furthermore, inflation has greatly impacted the cost of providing facilities for high growth States like Nevada and California. With all these changes putting significant upward pressure on rates, it would be easy but inaccurate to attribute future needs for the rate increases to the consent decree.

In the future, rates are undoubtedly going to change. It is my personal belief, however, that these changes would probably be the same in 5 or 10 years with or without the decree. However, I should point out that this assumes that the new access charges provided for in the consent decree will be set at levels that effectively replace the lost interexchange long distance subsidy without causing carriers and large users to establish facilities that bypass ours. This is a major issue, and how it is handled will certainly have a significant impact on local rates in California and Nevada.

Historically, Bell of Nevada and Pacific Telephone have provided unlimited usage of local service at very low cost flat rates. I can appreciate the fact that some people may not like the idea of moving away from flat rates for local service, but I believe we must if we are going to continue to provide low cost, affordable telephone service, service that is priced on the basis of usage, so that those who create the cost pay the cost.

It is this kind of pricing structure that will give us the financial strength to meet the technological needs of our most sophisticated business customers, while at the same time enjoying reasonably priced basic telephone service. We need to fully embrace pricing plans that will be based on the notion that customers pay for what they use and only for what they use. I believe our success in holding down rates will depend on such pricing structures.

Having said that, I think it is important to place the relative cost of telephone service in perspective. In the last 8 years, Nevada Bell has increased the cost of residence service only twice in that period. The cost of local residence service we provided has gone up by $2.95 per month.

For those of you who may be referring to my prepared testimony, there is an error in that testimony. It says $2.40 per month. I would appreciate it if you would change that to $2.95 per month.

Senator CANNON. I was just going to ask, has it increased that much since you wrote this statement?

Mr. GUINN. If it has, Senator, you would not want to hold another hearing tomorrow, would you? A modest increase, I might point out, compared to other consumer items.

A look at the historical progression of the Consumer Price Index clearly indicates that telephone rates have increased by only a fraction of those of other goods and services. The figures I will cite are from the California CPI, since no comparable figures are available for Nevada, but I would guess that the trend in Nevada has followed a similar pattern.

Since 1974, telephone service has increased by less than 20 percent, yet food has gone up 75 percent. Transportation is up 112 percent, and housing has increased over 120 percent. My point is that in our efforts to discover and develop new sources of revenue wherever they exist. In addition to AMPS, the advanced mobile phone service, we expect to offer transmission facilities for sensor-based home energy systems and for meter reading, video teleconferencing, electronic banking, and an ever-increasing array of voice telecommunications services.

At this point, I want to address the issue of Pacific and Nevada Bell's relationship. I would expect that after divestiture the relationship between the two entities will continue much as it is now. Nevada Bell will remain a subsidiary that pays dividends on its stock, all of which Pacific owns. The companies have been and are now consolidated for financial reporting purposes. Nevada Bell's revenues, investments, and expenses are combined with Pacific's. We see no reason for this arrangement to change.

However, we do not see this in any way as a problem for Nevada customers, regulators, or employees. In fixing rates for California customers, the California Commission looks only at California operations. The same is true for Nevada. The Nevada Commission looks only at Nevada operations. Nevada Bell has historically served Nevada with fair, reasonable rates. Nevada Bell has worked well with its regulatory and other agencies. It has a good reputation for quality service. It has modern, high technology plants and facilities. It has a loyal, dedicated work force, and it will remain a strong company, just as will Pacific.

At this point, I want to conclude these remarks with a few words about pending congressional legislation. At the present time, Judge Greene, the Department of Justice, and the FCC are all attempting to sort out the many complex issues related to the future of the telecommunications industry in the United States. Internally within the Bell System we are also planning for divestiture, inarguably, the most complex planning process ever undertaken by American industry.

I would suggest that now is simply not the time to introduce the additional variable of Federal legislation like H.R. 5158, the bill presently being considered by the House Subcommittee on Telecommunications, Consumer Protection, and Finance. I believe the public would be better served if the Congress waited until the judicial process has been completed. Then the time will be appropriate to consider what legislation might be needed.

I have covered a lot of ground in the time that you have generously allotted me here today. I look forward to answering any questions you may have about the subjects I have raised or, for that matter, anything else that will be raised this morning.

First, I want to conclude with a reassurance, a reassurance that Bell of Nevada and Pacific Telephone are strong, healthy companies. We are today and we will be strong, healthy companies after divestiture. We have the technology, the skilled people, and the customer base to make us successful. We see many business opportunities for the local exchange companies. What we need now is not legislation, but a finalization of the consent decree, so that we can get on about our business, and of course we need a close, supportive working relationship with our regulators so that we can achieve the benefits of the information age, and continue to make available affordable telephone service to all our customers in Nevada and California.

Thank you again for this opportunity to present my views.

Senator CANNON. Thank you very much, Mr. Guinn.

Next we will hear from Mr. Richard K. VanAllen, vice president and general manager, Nevada Bell.

STATEMENT OF RICHARD K. VAN ALLEN, VICE PRESIDENT AND GENERAL MANAGER, NEVADA BELL

Mr. VANALLEN. Thank you, Senator.

Good morning. I am Dick VanAllen, vice president and general manager of the Bell Telephone Co. of Nevada. I am pleased to have the opportunity to be here to offer Nevada Bell's perspective on the consent decree of 1982.

The issues facing us are indeed complex. The debate over the information revolution has continued pretty much unabated for more than a decade. The issues relating to how telecommunications should be delivered to the Nation have been debated in the Halls of Congress, in the regulatory arenas, in the courts, in the media, and in public forums of all kinds. One thing is very clear. Customers want dependable local phone service at affordable rates.

The new configuration of the stand-alone companies called for in the consent decree certainly represents a significant change in the way we will do business. I want to talk specifically about the viability of Nevada Bell under this change, and I would like to address specifically three items, quality of service, the cost of that service, and the impact of the consent decree on Nevada Bell's employees.

I firmly believe that we are not only willing but we are able to continue to provide high quality exchange services, the kind of services that our customers have come to expect. Nevada Bell has been challenged in recent years to meet the high demand for communications services which accompanies significant growth. At the same time, we have been challenged to meet the demand for more sophisticated telecommunications products and services. Nevada Bell presently has nearly 2,700 employees to serve some 124,000 business and residence customers.

Quality of service has always been a central concern for us. To provide quality services we have implemented an aggressive construction and modernization program. At the end of 1981, we had a net investment of $354 million in telecommunications facilities. Some $164 million of this was put in place during the last 4 years, and we are continuing to invest heavily. Our construction program for 1981 was $72 million, and we are spending approximately $80 million during 1982 to meet the requirements of growth, customer movement, facility replacement, and modernization. About $16 million of this will actually be for local exchange electronic switching equipment. This newer equipment provides more reliable and sophisticated services to our customers. It requires less maintenance, less space to house, and consumes less energy.

Seventy-seven percent of Nevada Bell's customers will be served by electronic technology by the end of 1982, and this will be 96 percent by the end of 1983. I am confident that this will probably be the highest percent within the Bell System, at the end of next year.

Today's electronic telecommunications network can provide special features and services unheard of just a few years ago. New services and network capabilities under development by the Bell System and a host of competitive communications companies will bring new communications opportunities to Nevada Bell's customers.

We actually see ourselves as the link that will connect the homes and businesses in our serving areas to the computer data bases and information systems. We will become the local delivery system for all types of communications services. More than 95 percent of American families now have access to basic telephone services. We have achieved universal telephone service. The challenge for the eighties is to move toward universal telecommunications service. That is, the ability to provide our customers with access to communications services from any source, in any form, at any time and place, at reasonable cost.

I have talked about quality of service and the different types of service which may be offered through the new organizational structure, but of course a big question is, what are these services going to cost our customers? As has been noted, basic telephone rates have been rising. Rates were rising long before the consent decree was announced. In recent years, forces such as competition and inflation have operated to drive rates toward costs.

Last year, Nevada Bell was granted an $8.2 million general rate increase, the first in 5 years. But the $2.40 monthly increase in rates for basic residential service is far below the inflationary increases in other areas of our economy. These pressures will cause telephone rates to rise again probably next year. Our pricing structure will have to be varied enough to accommodate everyone, from customers desiring only basic limited service to those with sophisticated and complex communications requirements.

Now, the third item I want to touch on today concerns Nevada Bell's dedicated and skilled work force. As the future of our service is promising, so are the employment opportunities within Nevada Bell. We will continue to have a need for employees with diverse skills and talents. As the economy grows and the new technology brings new service offerings, our people will find a multitude of challenges and opportunities. We will continue our ongoing commitment to provide good working conditions, good benefits, and good training for all of our employees.

I am not trying to imply that I have absolutely no concerns about Nevada Bell's future. Facing such a massive restructuring with so much at stake for so many does cause some trepidation. However, I do firmly believe that it is important that we follow a logical sequence of events over the next several months.

First of all, Judge Greene must complete his hearings, and either approve the decree or ask that it be modified. Then, A.T. & T. and the Justice Department must agree on a divestiture plan. There will then be a basis on which to evaluate the need for legislation. I believe that it is important to all of us that we move forward in an organized manner, so that we are able to form our conclusions on an informed basis.

Again, Senator, I would like to thank you for the opportunity to participate in the hearings, and I look forward to the question session later on.

Senator CANNON. All right. Thank you, Dick.

Next, we will hear from John Christian, president, Lincoln County Telephone Co. John.

STATEMENT OF JOHN CHRISTIAN, SR., PRESIDENT, LINCOLN COUNTY TELEPHONE SYSTEM, INC.

Mr. CHRISTIAN. Mr. Chairman and members of the Senate Committee on Commerce, Science, and Transportation——

Senator CANNON. Pull that back to you, John. I am not sure they can all hear you.

Mr. CHRISTIAN. My statement does not go into a detailed analysis of the various technical aspects of the proposed A.T. & T. antitrust settlement. This testimony is being presented to give a rural telephone company's perspective of the impact of the proposed A.T. & T. antitrust settlement with the U.S. Department of Justice, as well as the impact of various other federally mandated, approved, and proposed changes in telecommunications regulations.

The effects of the A.T. & T. settlement and the proposed changes in long distance toll regulation are necessarily related to each other. This is because the A.T. & T. settlement includes as one of its important parts the substitution of a new and different method of pricing and cost allocation for toll calls.

The Lincoln County Tel System, Inc., is a rural telephone company, headquartered in Pioche, Nev., and serves an area of approximately 10,000 square miles, with a population of approximately 3,700. The company currently has 1,310 main stations, excluding pay phones and company phones with a total of 2,484 phones served by 6 exchanges. The company's gross investment in telephone plant is $7,105,000. The total capital of the company is made up of $5,191,000 of debt and $1,708,000 of stockholders' equity invested and reinvested in the company.

Lincoln County Tel is a closely held corporation owned by the Christian and Smith families. Its gross revenue for 1981 was $1,879,000, made up of $1,633,000 of toll revenue at $246,000 of exchange and miscellaneous revenue, with toll revenue representing 87 percent of gross revenue. The stockholder equity and debt structure of Lincoln County Tel and its relative proportion of toll and exchange revenue are typical of many rural telephone companies. For many of our customers, their telephone is the contact with the outside world, and historically, our company has been able to provide affordable telephone services to all desiring it within our service area.

It is our understanding that the proposed A.T. & T. antitrust settlement has as one of its main goals the introduction of large-scale, multiple-company competition into the field of telecommunications. Lincoln County Tel does not see anything inherently wrong with a goal of having competitive markets within those parts of our Nation's telecommunications network which are not natural monopolies.

However, there is a real danger that rural telephone companies such as our company will find themselves in a severely weakened financial condition, and that many of their subscribers will find themselves unable to afford telephone service if safeguards are not built into any such transition to competition in this formerly heavily regulated industry.

Universal telephone service has been a long-established policy in the United States, and has had as its goal the maintenance of very low local exchange rates, which result in almost all Americans having telephone service. It is hard for me to believe that it is the desire of Congress or the people to change this policy in a country so dependent upon telephone service. The proposed antitrust settlement as well as Senate and House legislation propose a change to reliance upon a system of exchange access charges to provide contribution from interexchange service, for example, toll service, toward the cost of maintaining local exchange facilities.

Historically, the large cost contribution generated from the monopoly offering of interstate and intrastate toll services has been to offset part of the costs incurred by maintaining low local exchange rates, thereby guaranteeing universal telephone service. This has been accomplished through separations and settlements procedures which will be replaced by the proposed system of exchange access charges. Competition will by definition tend to reduce prices on toll service to the minimum, and therefore will not ordinarily leave any surplus as a support for local exchange costs.

Therefore, it is clear that any newly proposed access charges will be a crucial element in any program to retain universal telephone services. Unless these newly proposed access charges contribute sufficient revenues to rural telephone companies such as ours, the local exchange rates charged to our customers will have to be increased dramatically. Certain changes already ordered by the FCC in separations and settlement procedures as well as proposed changes in the assignment of shared costs in such interexchange services will greatly reduce the revenue which our company will receive for message toll.

Therefore, large increases in our local exchange rates will be required unless adequate offsetting revenue provisions are built into the restructuring of the industry. At the present time, the FCC has directed that additions to customer premise equipment after January 1, 1983, will not be included in toll settlements. The removal of CPE from toll settlements amounts to a decrease of $154,000, or a 20-percent decrease in interstate toll revenue for our company.

Absent an equal increase in local exchange revenues, this reduction in interstate toll revenue would result in a reduction of earnings before taxes by the same $154,000.

Further, it appears that the FCC may order a permanent change in the method of assigning costs in such settlement procedures from the subscriber plant factor method to the subscriber line usage method which would decrease our interstate toll revenues by an additional $289,300, or 38 percent. The effect of both of these changes, when implemented, on our interstate message toll revenues would be a consolidated net decrease of $325,100, or a 42-percent decrease in interstate toll revenue for our company.

The true impact of these changes when implemented must be viewed in human terms, however. If this net decrease in interstate message toll revenue is divided among the company's 1,310 main station subscribers, we arrive at a figure of approximately $21 per customer per month which must come from an increase in local exchange rates.

At the present time, the company's charge for one-party residence service is $4.75, and for one-party business services, $7, and therefore such an increase would amount to in excess of a 400-percent increase in the local monthly rate for a one-party residence subscriber or in other words a new rate five times the present rate.

Along with the foregoing changes, the FCC has also mandated a change in accounting for station connections which has required the company to file tariffs to increase its residence installation charge from $4.75 to over $50. This increase is wholly separate from any projected increases in monthly exchange rates.

In addition to these changes taking place at the federal level, there is currently a proposal by Bell Telephone Co. of Nevada at the State level to change the method of toll settlements for the independent companies from a statewide overall rate of return to a State toll rate of return. If such a method is adopted by the Nevada Public Service Commission, Lincoln County Tel will experience an additional $92,000 per year decrease in State toll revenues, which translates to an additional $6 per main station per month which must be made up by the company in some form.

In the aggregate, all of the changes discussed herein would bring our $4.75 one party residence service monthly charge to $31.75 per month and counting. It is clear from the foregoing that certain changes at the federal level already approved and those in the proposal stage as well as changes proposed at the State level will have a drastic impact on Lincoln County Tel's revenue flow. This negative impact on the company's revenue flow will make it necessary to greatly increase the local exchange charges made to its customers in the absence of any other offsetting revenue increases.

The only source of the revenue increase under the direct control of the company is an increase in its local exchange rates and installation and repair charges, and even these rates are subject to the approval of the Nevada Public Service Commission. Another possible source of increased revenue would be the intrastate toll rates currently set by the Nevada Public Service Commission. However, it is the company's feeling that the main source of offset for such current and proposed revenue decreases must be adequate and compensatory exchange access charges to provide contribution from interexchange service to offset the costs of rural telephone companies.

The State regulatory commissions and the Federal Government must realize that the loss of universal telephone service would affect many more than just those who would not be able to afford having a telephone in their home. Telecommunications are two-way communcations, and therefore businesses would not be able to contact potential customers who do not have phones and customers without phones cannot call businesses. Federal, State, and local agencies would not be able to contact their various constituencies or be contacted by them without making a trip to the individual's residence.

These are just a few examples of the effect of eliminating one end of our two-way communications system encompassed in universal telephone service.

A.T. & T. data presented during the course of the antitrust case showed that 91.5 percent of the American households now have basic telephone service. These percentages would drop to 83.7 percent if the price of basic phone service, the local exchange rate was doubled, and further decreased to 70.9 percent at triple the basic phone cost. If this occurs, instead of 1,310 main stations to make up the lost revenue effect we may have only 1,040 main stations, and therefore each remaining customer will have to bear a higher proportion of the increased charges. We do not have an estimate for the effect of a quintupled rate.

Some State regulatory commissions do see basic telephone rates tripling by 1985, and it is clear that such increases will fall most heavily on low income families, senior citizens, and the handicapped. These three specific groups of citizens within the populace rely very heavily on various government agencies for assistance. It is conceivable that such government agencies may very well have to return to that period in history when their employees needed a government vehicle at their disposal to travel out to their welfare recipients, senior citizens, and handicapped citizens.

Viewed in this perspective of two-way communications, it is clear that the cost of increased basic telephone charges goes far beyond the dollar increase to the respective telephone subscribers.

Speaking for Lincoln County Tel as a rural telephone company and myself as an individual, it would indeed be a tragedy if the goal of introducing a new competitive market for telecommunications products and services results in depriving a large number of current telephone customers of the basic telephone service they have come to expect over the years. All of the changes discussed in this testimony which are bringing about increased costs to local telephone companies are not the product of our elected representatives in Congress, but rather the product of the FCC, A.T. & T., the Department of Justice, and the courts.

As mentioned at the beginning of this testimony, the policy of universal telephone service has apparently not been altered, and therefore Congress should make its will known and clearly reassert our Nation's policy in this matter. The FCC, A.T. & T., the Department of Justice, and the courts are not composed of our elected officials, while Congress is answerable to the electorate, and therefore it is obligated to protect the interests of the local telephone customer during the process of the A.T. & T. antitrust settlement and related regulatory changes.

Thank you, Senator Cannon, for allowing me to appear before you today to express my company's concerns regarding the changes taking place in the telecommunications industry.

Senator CANNON. Thank you very much, John. You certainly pointed out some of the concerns that we have on the committee in considering this legislation. I would point out to you that in the legislation passed by the Senate last year, I offered an amendment that would have guaranteed that rural rates would not go up unduly, in particular not go up over 110 percent of the national average rates. Now, the Senate agreed to that amendment, and that bill that we passed is now being considered by the House. As you know, the House bill has some features along that line, as well as a lot of others that a lot of people are concerned about.

All right, next we will hear from Mr. Jeff Kushan. Mr. Kushan is vice president, government relations, Southern Pacific Communications Co.

STATEMENT OF JEFF KUSHAN, VICE PRESIDENT, GOVERNMENT RELATIONS, SOUTHERN PACIFIC COMMUNICATIONS CO.

Mr. **Kushan**. Thank you very much, Senator.

My name is Jeff Kushan. I am vice president, government relations, SPC, and I am grateful for this opportunity to testify. My testimony today will outline the role that SPC plays in both the national and Nevada communications markets, positive aspects of the proposed settlement, and clarifications and refinements in the settlement that SPC supports.

SPC is one of several new long distance telecommunications companies competing against A.T. & T. SPRINT is the name of our best-known service. We own our own long-distance microwave transmission facilities, and we now serve over 167 metropolitan areas across the country. We have over 180,000 subscribers, and we employ about 2,100 people throughout the United States, with the highest concentration in our Burlingame, Calif., headquarters.

SPCC is a wholly owned subsidiary of the Southern Pacific Co., most widely known for its railroad subsidiary, and in Reno, in northern Nevada, for the role it has played in its colorful history and development. Nevada is one of 36 States that SPC serves on its national network. We have over 5,000 customers in the State 1,900 customers in Reno, and 3,100 in Las Vegas. Of this number, 3,600 are residential customers and 1,400 are business customers.

We began service in Reno and Las Vegas, Nev., in 1979. Today, we have over 405 miles of microwave network in the State, with 11 microwave sites, and a major technical operating center here in Reno.

SPC provides only the long distance portion of the telephone call. We do not provide local telephone service, since that has always been recognized as a monopoly service. To originate and terminate our calls to customers in Nevada, we rent access lines from the local telephone company, either Nevada Bell, Cen Tel of Nevada, or P.T. & T. On the average we pay about $130 per line per month for access to the local telephone companies' facilties and services.

Charges for local access constitute almost 25 percent of our total gross revenues, and keep in mind that what we are getting is nothing more than business lines which your customer's Mr. Christian, pay $7 a month for.

Turning now to the settlement, I would like to begin by saying that the proposed settlement would end the captive interlock arrangement between the local and long distance service of the Bell System that created many of the incentives for anticompetitive behavior. This is the solution that SPC has long sought. The real impact of the settlement will not be fully known until the details of the divestiture plan are made public, have been commented upon, finally approved, and then implemented.

We believe that if the settlement agreement is properly refined and implemented, long distance service can eventually be a truly competitive communications service.

There are many positive aspects of the settlement, from our viewpoint. Here I will mention only four. First, the settlement separates A.T. & T. in the proper place. Local and long distance services are separate markets with different technical, physical, and functional characteristics. The A.T. & T. settlement properly establishes an industry framework where local companies will no longer have the same incentive to treat one long distance carrier in a more favorable manner. We look forward to a future where local companies will look to each long distance carrier as a potential customer, not as a competitor.

Second, the settlement enhances the ability of regulators to protect ratepayers. By drawing a corporate dividing line between local and long distance, A.T. & T. will be forced to place plant, equipment, personnel, and so forth in either the corporate entity that is providing the local service or in the entity that provides the long distance service. Transactions between them will then be more visible for scrutiny by regulators, competitors, and the public, as well as stockholders.

Third, the settlement encourages a shift in the industry to cost base pricing. In the monopoly environment of the past, cost base pricing was not essential, and rarely, if ever, practiced. However, the technological advances that brought competition to the communications industry have made the monopoly noncost based arrangements within A.T. & T. obsolete.

Fourth, the settlement reorganizes a monopoly structure that was causing technological stagnation. It will allow local telephone companies to be much more autonomous in decisionmaking. We believe that profitseeking, separately owned and managed local telephone companies will be more capable of delivering quality telecommunications than A.T. & T. as a single owner and controller of the Bell System has been able to do in the past. Quite frankly, we think it increases the amount of good business talent in the entire telecommunications industry.

While SPCC strongly endorses the basic principles outlined in the settlement, we also support certain clarifications and refinements. First, under the proposed settlement, A.T. & T. would be the only carrier that could seek colocation of its facilities and joint use of its equipment with the local operating companies. This right would be extended not only to currently existing facilities but to all facilities built in the future, so that A.T. & T. would be able to share buildings and equipment with the local operating companies.

We believe that all long distance carriers should have the option to purchase physical access to local telephone users identical to that which any other carrier enjoys, including colocation of facilities and joint use of equipment.

A related problem is that the proposed settlement would leave vague the rates that should be charged for exchange access until such time as the equal access provisions of the consent decree become effective. We would like to see access charge rates frozen until equal access at equal charges is available. This would certainly increase the incentive to offer true equal access to the competitive interexchange carriers.

The Bell operating companies' relationship to A.T. & T. will change drastically as time passes. To insure that the operating companies' interests are represented, the court may consider appointing a special master or joint board to assist them in their consideration of the consent decree.

Finally, we believe that procedures should be adopted so that public comment and scrutiny can be given to the details of the divestiture plan and the procedures for insuring equal access. At present, only a very preliminary approval process is needed.

In summary, while SPCC agrees with the fundamental restructuring in the proposed settlement, we also acknowledge that in 13 pages, only a framework has been laid out for us. Within that framework there are a staggering number of questions to be answered and decisions to be made. SPCC plans to participate fully under the procedures established by Judge Greene, and we trust that he, the Justice Department officials and the legal system of the country will meet the task at hand.

Thank you, Senator.

[The statement follows:]

STATEMENT OF E. J. KUSHAN, VICE PRESIDENT, GOVERNMENT RELATIONS, SOUTHERN PACIFIC COMMUNICATIONS CO.

INTRODUCTON

My name is E. J. Kushan, and I am Vice President, Government Relations of the Southern Pacific Communications Company (SPCC). I am grateful for this opportunity to testify regarding the recent proposed settlement of the AT&T antitrust case.

My testimony today will outline the role that SPCC plays in both the national and Nevada communications market, positive aspects of the proposed settlement and clarifications and refinements that SPCC supports.

I. SPCC AND COMPETITION IN THE LONG DISTANCE MARKET

SPCC is one of several new long distance telecommunications companies competing against AT&T. SPRINT is the name of our best known service. We own our own long distance microwave transmission facilities and rely upon the local telephone companies to provide call origination and termination service through local access lines. Our transmission system will be futher enhanced by the launch of two communications satellites in 1984.

SPCC now serves 167 metropolitan areas across the country using its terrestrial microwave system consisting of 46.2 million circuit miles. We have over 180,000 subscribers—including 100,000 residential and 80,000 business customers. Currently we employ 2,100 people throughout the United States with the highest concentraton in our Burlingame, California corporate headquarters. SPCC is a wholly owned subsidiary of the Southern Pacific Company, most widely known for its railroad service.

The year 1981 was historic for our company because we registered our first profitable year. With capital assets of nearly $325 million and revenues of $234.5 million, SPCC earned operating profits of $34.1 million before deductions of interest on our debt. We were encouraged by this develpment, although we still face massive capital investment requirements in the coming years. This year, for example, we plan a construction budget of nearly $150 million.

II. SPCC'S SERVICE IN NEVADA

Nevada is one of the 36 states that SPCC serves on its national network. Over 5,000 customers in this state subscribe to our services. In Reno we serve 1,900 customers and in Las Vegas we serve 3,100. Of this number, 3,600 are residential customers and 1,400 are business customers. Our network does not extend to all points in the State of Nevada. Attachment A shows the exchange areas where SPRINT service is available in the Reno and Las Vegas areas. SPCC began service to Reno in July of 1979 and to Las Vegas in November of 1979. Today there are 405 miles of SPCC's network in Nevada, 11 microwave sites, and a technical operating center in Reno.

SPCC provides only the long distance portion of the telephone call. We do not provide local telephone service since that has always been recognized as a monopoly service. To deliver our calls to customers in Nevada, we rent telephone lines from the local telephone company, either Nevada Bell, Centel of Nevada or PT&T. In Reno we are currently renting 84 lines and in Las Vegas 98 lines. On the average, we pay about $130 per line per month for access to the local telephone company's facilities and services. Charges for local exchange access constitute almost 25 percent of our gross revenues. As you know, Senator Cannon, the tariff under which we pay for local access expires in about two weeks and AT&T has proposed to almost triple those rates. SPCC very much appreciates your letter to the FCC written on our behalf asking that the Commission carefully scrutinize this proposed AT&T rate increase.

III. BACKGROUND LEADING TO SETTLEMENT—AT&T'S BEHAVIOR

The lawsuit filed by the U.S. Justice Department in 1974 against AT&T was not aimed only at AT&T's size but also at its behavior. The captive relationship between and among the Bell System's manufacturing, long distance and local service was being used to retard the growth of competition.

The proposed settlement would end the captive interlock arrangement between local and long distance services of the Bell System that created many of the incentives for anticompetitive behavior. This is the solution that SPCC has long sought. In testimony last July, for example, we stated: "The cleanest way to promote competition in the long distance transmission business is to restructure the industry by making the local bottleneck telephone facilities and services separate from long distance."[1]

SPCC, as a member of FOCUS (Fair Opportunities for Competition in the United States), has advocated the creation of a competitive environment for telecommunications services and products that will encourage competition and innovation, reduce costs, improve services and technology, and promote jobs, consumer interests, foreign sales and the national defense.[2] The means FOCUS recommended to achieve this end was complete separation of the Bell Operating Companies, Long Lines, and Western Electric. The most important element of the FOCUS recommendation—the divestiture of the Bell Operating Companies—is the remedy that AT&T and the Justice Department agreed upon as the most workable resolution of the antitrust suit.

While the nature of the divestiture envisioned by the proposed settlement does not resolve all of the concerns that SPCC, as a competitor of AT&T's long distance services, felt existed in the prior vertically integrated arrangement, it clearly addresses many of those concerns. The real impact of the settlement will not be fully known until the details of the divestiture plan are made public, have been commented on, finally approved, and implemented.

We believe that if the settlement agreement is properly refined and implemented, long distance service can eventually be a truly competitive communications service.

IV. POSITIVE ASPECTS OF SETTLEMENT

A. Separates AT&T in the proper place—where technology and business experience draw the line

Local and long distance service are separate markets with different technical, physical and functional characteristics. Local service is more labor intensive than long distance. There are different marketing approaches used and today there is limited competition in the long distance market while the local market remains a monopoly.

By separating the local operating company functions from long distance functions, we believe the AT&T settlement properly establishes an industry framework that will promote the most efficient, low cost service to the public. Local telephone companies will no longer have the same incentive to treat one long distance carrier in a favorable manner. We look forward to a future where local companies will look to each long distance carrier as a potential customer, not as a competitor. The settlement helps to remove the anticompetitive incentives of the local Bell telephone companies.

While we support the principals of separation embodied in the 13 page proposed settlement, we acknowledge that the details and the actual process for implementing this separation will be critical. The process will be extremely complicated and detailed as would be expected with such a large reorganization and asset transfer.

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[1] July 23, 1981, testimony before the Senate Judiciary Committee regarding Monopolization and Competition in the Telecommunications Industry.

[2] The Case for the Divestiture of AT&T, p. 2.

Because of the importance of this process, we believe an opportunity for public comment on the specific details and procedures for separation are necessary.

B. Enhances the ability of regulators to protect ratepayers

The division proposed by the settlement will enhance the ability of both state and Federal regulators to protect the public. By drawing a corporate dividing line between local and long distance, AT&T will be forced to place plant equipment personnel, etc., in either the corporate entity providing local service or in the entity providing long distance service. Transactions between them will then be more visible for scrutiny by regulators, competitors and the public, as well as stockholders. The amount of personal and financial resources needed to regulate, both at Federal and state levels, will be reduced.

C. Encourages a shift in the industry to cost based pricing

Separation of AT&T as proposed in the settlement will bring to an end an industry managed system of money flows that in some cases is described as a welfare system, and in other cases, as a system of black magic. In the monopoly environment of the past, cost based pricing was not essential and rarely, if ever practiced. However, the technological advances that brought competition to the communications industry have made the monopoly, non-cost based arrangements within AT&T obsolete. The settlement will help bring the industry to a more cost based system, and it need not cause significant disruption to local service rates.

D. Reorganizes a monopoly structure that was causing technological stagnation

Restructuring of the Bell System in the proposed settlement will allow local telephone companies to be much more autonomous in decisionmaking. We believe that profit-seeking separately owned and managed local telephone companies will be more capable of delivering quality telecommunications than AT&T as a single owner and controller of the Bell System. As a result of the settlement, decisionmaking authority for purchasing will rest exclusively with the management of the local companies—either 7 or 22. Local companies will be able to make procurement decisions for CPE, long distance service, switches, equipment, etc., based on local and regional needs. Quite frankly, we think it increases the amount of good business talent in the telecommunications industry.

We are confident that with enlightened regulation, local telephone companies will be viable entities. The proposed settlement's restriction of local operating companies to regulated monopoly services is an important means of avoiding cross-subsidization. If, as a means of ensuring viability of the local operating companies, they were allowed to provide both regulated and competitive services, we would inevitably set the stage for the same problems that gave rise to the suit. Local companies would have an incentive to allocate excess costs to the regulated portion of the business, and therefore, subsidize their competitive activities. As long as the local companies are allowed a reasonable rate of return, they should be restricted to regulated activities.

V. CLARIFICATIONS AND REFINEMENTS SPCC SUPPORTS

While SPCC strongly endorses the basic principles outlined in the settlement, we believe it should be modified in a number of areas to enhance the development of a truly competitive industry. Listed below are three areas, although there are others as well, which we will discuss in written comments to Judge Greene.

A. Exchange access and access charges

Under the proposed settlement, AT&T would be given certain advantages that the competitors would not have. For example, AT&T would be the only carrier that could seek colocation of its facilities and joint use of equipment owned by the local companies. This right would be extended not only to currently existing facilities, but to all facilities built in the future. The proposed settlement also would allow AT&T to keep for itself certain equipment necessary to reach the local phone users (the so-called "Class 4" switch).

We believe regulated carriers should provide access at any point requested, whether owned by AT&T or the local exchange carrier. All long distance carriers should have the option to purchase physical access to local telephone users identical to that which any other carrier enjoys, including colocation of facilities and joint use of equipment.

A related problem is that the proposed settlement would leave vague the rates that should be charged for exchange access until such time as the equal access at equal charges requirement becomes effective. This transition period should not be an opportunity for AT&T to unfairly impede the growth of the competing intercity carriers. We would like to see access charge rates for comparable service that existed on January 1, 1982 continue to apply until equal access at equal charges is available under the proposed settlement. This would increase the incentive to offer equal access.

B. Bell Operating Co. viability

It appears that as the details of the settlement are worked out, it will become more important for the Bell Operating Companies' interests to be adequately represented. Their relationship to the parent, AT&T Company, will change drastically as time passes. To ensure that Bell Operating Company interests are represented, the Court might consider appointing a Special Master or Joint Board.

Any plan of divestiture should maximize the economic return on the operations to be sold or spun off as well as those of the parent company. The businesses to be divested should carry with them the assets necessary so that they are able to operate as viable economic entities. Some redeployment of assets and assumption of liabilities among the entities may be required. We do not believe that the settlement unfairly disadvantages the local companies. We say this with the understanding that it is essential for SPCC and all long distance carriers to have healthy and viable operating companies.

C. Public comment

The Congressional intent embodied in the Tunney Act was to facilitate public comment on proposed consent decrees. To ensure that Judge Greene is not asked to simply sign a blank check, procedures should be adopted so that public comment and scrutiny can be given to the details of the divestiture plan and the procedures for ensuring equal access.

SUMMARY

While SPCC agrees with the fundamental restructuring in the proposed settlement, we also acknowledge that in 13 pages, only a framework has been laid out for us. Within that framework there are a staggering number of questions to be answered and decisions to be made. Many will be critically important to different segments of the industry. SPCC plans to participate fully under the procedures established by Judge Greene and we trust that he, U.S. Justice Department officials and the legal system of this country will meet the task at hand.

Senator CANNON. Thank you very much, Mr. Kushan. Do we have any kind of an estimate as to when Judge Greene is likely to complete the proceedings? Has he given any indication of how long he thinks?

Mr. KUSHAN. The first comments are due April 20, but I do not know how soon after that we will hear anything.

Mr. DEBOIS. He has not committed himself to any time period.

Senator CANNON. All right.

Mr. DEBOIS. I would say the middle of the summer would be the earliest.

Senator CANNON. All right.

We will next hear from Mr. Marvin McGee, senior Bell account executive, Lynch Communications System. Mr. McGee.

STATEMENT OF MARVIN McGEE, SENIOR BELL ACCOUNT EXECUTIVE, LYNCH COMMUNICATIONS SYSTEM, INC.

Mr. MCGEE. Thank you, Senator.

We welcome this opportunity to participate in this testimony on these very vital issues.

Senator CANNON. Can you pull that microphone a little closer to you?

Mr. MCGEE. I am Marvin McGee, from Lynch Communications in Reno. As ratepayers at Lynch we are, of course, concerned regarding local long distance service and the rates we pay, both as individuals and as a company. However, as one of Nevada's largest manufacturers, producing equipment and systems for the operating telephone companies in the United States, we are very concerned about the equipment procurement issues contained in the pending legislation, the proposed consent decree, and the nature of the marketplace with its attendant restrictions regarding information and specifications on new product needs by both the Long Lines Division and the Bell operating companies.

Employing around 1,000 people here in Reno, we are concerned about the equal treatment of all manufacturers in this procurement area. Our concern is the terms that are contained in the decree presently, as well as those indicated in the Justice Department's competitive impact statement. Western Electric, part of the overall Bell System, will be mandated to support the divested Bell operating companies in the procurement areas for some 5 to 6 years.

At the same time, they will be out competing in a marketplace where they have not been since the early 1950's, that is, with the independent marketplace in the United States. It is our concern as well as other manufacturers 'around the country, that the existing restrictive, competitive procurement situation within the Bell operating companies, which constitute 80 percent of the phones in the country at least, and turning Western Electric loose in a marketplace where some 500 firms are trying to make a living through their own entrepreneurial efforts, we feel that market deterioration could occur, and we would expect with market deterioration some amount of unspecified unemployment depending upon the amount of market deterioration.

The other area of major concern deals with part of S. 898, that was passed in October. It deals with the procurement of equipment by the operating companies from manufacturers that have a greater than 20—or a 20-percent foreign investment involvement. We can only suggest that that kind of trade policy might be conducted on an exclusive basis, and if that cannot be realized legislatively, then we strongly suggest that the 20-percent figure be revised upward to 50 percent so that foreign ownership is clearly indicated.

We think that in the procurement area, if the 20-percent foreign ownership figure is mandated, in some considerations for equipment companies would have to submit lists of their stockholders so that Bell could estimate and see whether or not they had over 20 percent foreign involvement. That is an area of major concern for us since, as a Nevada corporation, we have just signed an agreement with a French company, and they own 25 percent of our stock now.

So, Senator, I thank you for the opportunity to share these views with you. Our formal statement is a statement prepared by our counsel for submittal to the FCC in Washington, it is a statement representative of over 500 manufacturers in the United States.

Thank you very much.

Senator CANNON. Your formal statement will be made a part of the record in full, as will all of the others, if some of you abbreviated from them. Thank you very much, Mr. McGee.

[The statement follows:]

STATEMENT OF INDEPENDENT TELECOMMUNICATIONS SUPPLIERS COUNCIL

The Independent Telecommunications Suppliers Council (ITSC), by its attorneys, submits these comments in response to the Commission's March 4 Public Notice, inviting interested parties to present their views concerning the relationship of the proposed settlement agreement reached on Janury 8, 1982 in *U.S.* v. *AT&T*[1] to the Communication's Act of 1934 and specifically to the Commission's duty under Section 1 to regulate "interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide and world-wide wire and radio communications service with adequate facilities at reasonable charges." 47 U.S.C. § 151.

I. INTRODUCTION

ITSC is a coalition of over 500 independent (i.e. non-AT&T affiliated) manufacturers and suppliers of both network and terminal equipment, located throughout the United States.[2] Since its membership constitutes a substantial, broadly representative segment of the "general trade" sector of the telecommunications equipment industry, ITSC has a deep interest in the proposed settlement and its impact on the Commission's ongoing efforts to encourage the development of a fully competitive telecommunications equipment market, as a means of ensuring rapid, efficient service at the lowest possible cost to consumers.

In several ongoing proceedings, in particular Bell System Procurement Practices, FCC Docket No. 80-53,[3] the Commission has recognized a number of obstacles inherent in the Bell System's current structure and operation, which prevent the achievement of full and fair competition in the equipment industry. Pursuant to its statutory authority, the Commission has sought to remedy this situation. Although the proposed settlement will have an impact in this area, it clearly does not effect a total resolution of the Commission's concerns.[4]

With respect to those areas of FCC concern which the modification does address—i.e., local exchange equipment procurement by the Bell Operating Companies (BOCs)—ITSC believes that the Commission must carefully consider whether the pertinent provisions adequately resolve previously identified problems. Should the district court ultimately enter the proposed settlement, the Commission has the independent authority and the duty to continue its efforts under the Communications Act to remedy problems which remain.[5]

Additionally, a significant portion of current Bell System procurement—i.e., all equipment purchases related to the provision of intercity service—remains wholly unaddressed in the proposed settlement. The Commission recognized in Dockets 19129 and 80-53 that a continuation of present Bell System practices was not in the public interest. Clearly, continued FCC oversight of A.T. & T. equipment procurement is essential to the proper discharge of the Commission's statutory duty.[6]

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[1] Civ. No. 74-1698 (D.D.C. filed Nov. 20, 1974). The settlement agreement takes the form of a modification of the 1956 Western Electric consent decree. *United States* v. *Western Electric*, 1956 Trade Cases ¶ 68,246 (D.N.J. 1956).

[2] A list of ITSC members is attached as Appendix A.

[3] The Commission's Report and Order and Notice of Inquiry, In Re Bell System Procurement Practices [hereinafter, Report Docket No. 80-53] FCC Docket No. 80-53, FCC NO. 80-699 (released July 28, 1981) was issued to determine the best means of ensuring that BOC procurement met the "arms length, fair and equal" standard for BOC procurement mandated by the Commission's Phase II Final Decision and Order in Docket No. 19129, [hereinafter, Phase II Final Decision] 64 FCC 2d 1, 110 (1977); reconsideration, 67 FCC 2d 1429 (1978).

See also License Contract Agreements and Other Intrasystem Arrangements of the Major Telephone Systems, 84 FCC 2d 259 (released February 6, 1981).

[4] See discussion at 4-16 infra.

[5] See, e.g., *Otter Tail Power Co.* v. *U.S.*, 410 U.S. 366 (1973); *U.S.* v. *Terminal RR Assn.*, 224 U.S. 383 (1912). See also Hearings on H.R. 5158 Before the Subcommittee on Telecommunications, Consumer Protection and Finance of the House Committee on Energy and Commerce, 97 Cong., 1st Sess. (Feb. 17, 1982) (Statement of FCC Chairman Mark Fowler at 5-6).

The Commission might also, consistent with its earlier invitation to the court, indicate its willingness to provide assistance to the court in the implementation and supervision of specific aspects of the modification as entered, under the doctrine of primary jurisdiction. *U.S.* v. *A.T. & T.*, FCC Supplemental Memorandum as Amicus Curiae (Nov. 4, 1976) at 6.

[6] ITSC intends to urge in its Tunney Act comments that the proposed modification be amended to address the continuing problem of A.T. & T.'s equipment procurement. However, the FCC's statutory authority to regulate carrier procurement practices which affect the interstate ratepayer would remain, irrespective of such amendment, until existing problems are adequately resolved.

II. SINCE COMMISSION CONCERNS WITH RESPECT TO BOC PROCUREMENT OF LOCAL EXCHANGE EQUIPMENT ARE NOT FULLY RESOLVED BY THE PROPOSED SETTLEMENT, CONTINUED FCC SUPERVISION IS REQUIRED

The Commission concluded in its Final Decision in Docket 19129 that Western Electric (Western) enjoyed a "substantial competitive advantage" over general trade suppliers, due to its pervasive involvement in Bell System procurement.[7] This view was recently reaffirmed in the Commission's Report in Docket No. 80-53, which noted that the pro-Western bias created by Bell System practices "resulted in the BOCs' not always procuring the best equipment at the lowest prices." [8]

Under the terms of the proposed settlement, Western's involvement in BOC procurement will at best diminish only gradually. The Justice Department concedes in its Competitive Impact Statement that there may be transitional problems due to the "lingering effects that AT&T's pre-reorganizational structure may have on the BOC's future operations." [9] In its Pretrial Brief, the Department was even more emphatic, stating that "[o]ver the short run, there is a strong possibility that the Bell System will continue to provide a captive market for Western equipment because of residual institutional loyalty, inertia, and long-term reliance on Western as a purchasing agent." [10]

Indeed, the Modification permits and, in some cases, requires a perpetuation of existing relationships between the BOCs and the rest of the Bell System, including Western Electric. While Section I(A)(3) of the Modification requires that existing BOC License Contracts be terminated, there is no specific bar to other sorts of contractual arrangements between Bell Labs and the BOCs. Section I(C) obligates AT&T to provide "research, development, manufacturing and other support services" to the BOC's, on a priority basis, until September 1, 1987, "to enable the BOCs to fulfill the requirements of this Modification of Final Judgment." The Commission, in Docket No. 80-53, expressed deep concern over Bell Labs' role in providing Western with advance knowledge as to BOC equipment needs, as well as its ability to design systems around the capabilities of Bell's affiliated manufacturer, Western.[11] Although the Modification states that "AT&T and its affiliates shall take no action that interferes with the BOC's requirements of nondiscrimination," in the absence of any meaningful guidance as to what constitutes such "interference," the potential for abuse in this area remains quite high. The Commission must continue to monitor any continuing interaction between the BOCs and Bell Labs, so as to prevent such abuse.

In its Report in Docket No. 80-53, the Commission also found that Western involvement in BOC inventory management, warehousing, and distribution functions encourages BOC dependence on Western as their supplier.[12] The Modification does not indicate whether or to what extent AT&T's obligation, under Section I(A)(1), to transfer sufficient assets to permit the BOCs to perform exchange service functions (including procurement therefor) comtemplates the transfer of warehousing and distribution facilities presently used by Western to serve the BOCs. If these facilities are not transferred to the BOCs, Section I(C) may require that Western continue to provide such services. Again, given the proposed settlement's lack of specificity as to what sorts of relationships will be permitted during the transitional period and thereafter, there is a clear need for ongoing FCC scrutiny of such arrangements.

In addition to continuing organizational ties, any realistic appraisal of post-settlement BOC procurement must acknowledge the deep-seated institutional loyalty which BOC managers who may have spent their entire careers within the Bell System will undoubtedly retain, as well as the continuing impact which personal relationships—developed over the years between individual BOC managers and AT&T/Western officials—are likely to have, consciously or subconsciously, on BOC procurement decisions. As Judge Greene noted, in his opinion denying AT&T's motion to dismiss:

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[7] Phase II Final Decision at 38.

[8] Report Docket No. 80-53 at 6. The Commission found that the Bell procurement system "apparently functions today in a manner virtually identical to that described in 19129." Id. n. 15.

[9] Competitive Impact Statement (filed February 10, 1982) slip op. at 24. See also Assistant Attorney General Baxter's recent statement before the Senate Committee on Commerce, Science and Transportation ackowledging that "the divested operating companies may, for a period of time, retain some institutional loyalty and as a result of inertia continue to favor prior affiliates." Hearings on Recent Actions of the Department of Justice in *United States* v. *AT&T* Before the Senate Committee on Commerce, Science, and Transportation, 97th Cong., 1st Sess. (January 25, 1982) (Statement of William F. Baxter at 4-5).

[10] *U.S.* v. *AT&T*, Pretrial Brief for the United States (December 10, 1980) at 78.

[11] Report Docket No. 80-53 at 20.

[12] Id.

> Personnel rotate through Western Electric, Bell Labs, the Operating Companies, and AT&T central headquarters with some regularity, and they come to acquire a familial attitude towards the different parts of the Bell System as they rise through its ranks. Through this process, those holding management positions in the Bell Operating Companies appear to adopt the objectives, incentives, and prejudices of AT&T and Western top management as their own.[13]

The mere fact that the BOCs have been involuntarily separated from the rest of the "Bell family" will not immediately alter current attitudes.[14] Neither will the single injunctive provision contained in Section II(B)(1) of the Proposed Modification—which states without elaboration that no BOC shall discriminate between AT&T and "other persons" in its procurement of products and services—effect such change.

While the settlement requires that each BOC submit to DOJ procedures for insuring compliance with respect to all the injunctive provisions of Section II(B), no guidelines are given as to what the BOCs procurement procedures must include.[15] According to the timetable set out in the proposed settlement, compliance procedures may not have to be submitted until a full 2 years after the effective date of the Modification.[16] Neither the Department of Justice nor the court is required to formally approve BOC procedures. Clearly, continuing FCC involvement in the development and implementaiton of specific guidelines for BOC procurement is essential to the Commission's effective performance of its statutory obligations to the American ratepayer.

Moreover, the danger posed by continuing organizational ties and residual pro-Western bias is heightened to the extent that centralization of local exchange procurement is permitted under the proposed settlement. Some degree of centralization is already likely prior to divestment; A.T. & T. has announced tentative plans to reorganize the 22 Bell Operating Companies into 7 "operating regions".[17] In addition, Section I(B) of the Modification allows the reorganized BOCs to fund a central organization for "engineering, administrative and other purposes which can most efficiently be provided on a centralized basis." The risk that ratepayers will suffer serious harm due to lingering "buy Western" attitudes and continuing business ties is increased to the extent that the number of independent decisionmakers is reduced. Centralization prevents the development of "yardstick competition," which would provide a basis for more objectively assessing the validity of purchasing decisions. Furthermore, consolidating purchasing functions poses serious questions of monopsony, thus presenting further risks to the development of a fully competitive equipment market.

Although FCC authority to continue its inquiry into the post-divestiture procurement practices of the Bell Operating Companies may be questioned, prior precedent indicates that the Commission retains jurisdiction in this area. Since the cost of exchange equipment necessarily affects the level of exchange access charges ultimately charged to the interstate ratepayer, BOC procurement clearly falls within the interstate jurisdiction of the FCC. As is well-established, the physical location of equipment is not determinative; jurisdiction attaches pursuant to the use to which the facilities are put.[18] The FCC's right to review and to structure the purchasing of exchange equipment prior to divestiture is not altered thereafter.

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[13] *U.S.* v. *AT&T et al.*, Civ. No. 74-1698, Slip op. at 59 (D.D.C., Sept. 11, 1981).

[14] Indeed, the involuntary nature of divestiture could in fact create resentment among some operating managers, to the further disadvantage of general trade manufacturers and suppliers. Moreover, the reality is that most BOC managers will, individually, remain members of the "Bell family" by virtue of A.T. & T. stock holdings acquired during their tenure as Bell System employees.

[15] Although the proposed Modification's detailed equal exchange access provisions, set forth in Appendix B, remain deficient in certain respects—and are subject to future interpretation, alteration, or elimination by the parties—they stand in stark contrast to the minimal response made to the procurement problem, which has a far longer and at least equally well-documented history.

[16] Compliance procedures must be submitted within 6 months after reorganization, which may take place up to 18 months after the Modification's effective date.

[17] This tentative "planning model" could conceivably be altered to permit further consolidation; the Modification does not specify the minimum number of entities which may emerge from reorganization.

[18] See, e.g., *Telerent Leasing Corp.*, 45 FCC 2d 204 (1974), e.g., *Telerent Leasing Corp.*, 45 FCC 2d 204 (1974), aff'd sub nom. *North Carolina Utilities Comm'n* v. *FCC*, 537 F. 2d 787 (D.C. Cir.), cert. denied, 429 U.S. 1029 (1976).

III. CONTINUED COMMISSION OVERSIGHT OF AT&T EQUIPMENT PROCUREMENT IS ESSENTIAL, SINCE THE PROPOSED SETTLEMENT FAILS TO REMOVE AT&T'S ABILITY AND INCENTIVE TO "BUY-WESTERN"

Both Docket 80-53 and 19129 were expressly concerned with the procurement practices of the Long Lines Department of AT&T, as well as the BOCs.[19] Indeed, while noting that the BOCs "possibly may have incentives distinct from AT&T," the Commission observed that "Long Lines, however, as a department within AT&T, cannot be said to have incentives distinct from its own organization."[20]

Since the proposed settlement allows AT&T to retain Long Lines as well as Western Electric, while ordering divestment of Bell's local exchange operations, the congruence of interests remains. Indeed, the problems inherent in this affiliation are extended, since the Modification would permit AT&T to consolidate its intra and interstate toll operations in Long Lines.[21] More importantly, the proposed settlement fails to separate Bell's regulated monopoly from its unregulated competitive activities. As a result, AT&T will continue to have the ability as well as the incentive to use its dominance in interexchange service to (1) cross-subsidize its competitive equipment manufacturing and R&D activities, and (2) favor Western Electric products in procuring interexchange (toll) equipment, even where more desirable general trade products are available. In either instance, consumer welfare is reduced.

The Justice Department, in its Competitive Impact Statement, argues that the proposed settlement adequately deals with the threat of cross-subsidization and other anticompetitive procurement behavior, by requiring divestiture of AT&T's local exchange operations and imposing "equal access" requirements on the divested BOCs.[22] In short, the Department has concluded that the once the Modification becomes effective the Bell System will be unable to use its position in the interexchange service market to benefit Western Electric at the expense of interstate ratepayers. It is clear, however, that this conclusion reflects an overly optimistic view of the degree of intercity competition that exists today or that can reasonably be anticipated in the foreseeable future. This view is erroneously premised on the assumption that equal access to the local exchange bottleneck will in fact be achieved within the near future—despite the fact that the terms of the settlement are to the contrary.

In 1980, the Bell System together with the independent telephone companies received 97.6 percent of total industry metered and private line toll revenues.[23] AT&T's actual percentage ownership of intercity facilities has been fixed at 90 percent or more.[24] In response to AT&T's argument at trial that market share data failed to consider the rapid entry and expansion of new firms in intercity services, the Justice Department rightly noted: What defendants fail to mention, however, is that over the same two years [1978-1979] defendants own intercity revenues grew by over $5 billion. . . . The revenue of independent telephone companies from intercity service grew by $1.3 billion over the same period. The approximately $130 million growth by other common carriers in the context of over $6 billion growth in total revenues is scarcely evidence of a decline in defendant's monopoly power.[25]

As for the Department's presumption regarding "equal access," it should be noted that full implementation of the access obligations imposed on the BOCs by the terms of the proposed settlement will not take place for at least another 10 years.[26] AT&T may retain competitive advantages even after that date, in areas not explicitly covered by the settlement.[27] Moreover, the Bell System's control of local exchange access is by no means the only barrier to entry and survival in the interexchange service market. While regulatory barriers at the federal level are being reconsidered,[28] in many areas, intrastate toll remains the franchise monopoly of AT&T. Economic barriers to entry are also significant.[29]

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[19] See Report Docket No. 80-53 at 3, n. 6.

[20] Id. at 19-20.

[21] Paragraph I(A) of the Modification requires the transfer of all intrastate toll assets from the BOCs to AT&T.

[22] Competitive Impact Statement at 38-39.

[23] Majority Staff of the House Subcommittee on Telecommunications, Consumer Protection, and Finance, 97th Cong. 1st Sess., Report on Telecommunications in Transition: The Status of Competition in the Telecommuications Industry (Comm. Print 1981) at 105, Chart 12.

[24] See *U.S.* v. *AT&T*, Plaintiff's Memorandum in Opposition to Defendant's Motion for Involuntary Dismissal Under Rule 41(b) [hereinafter, Plaintiff's Response] (filed August 16, 1981) at 44, citing testimony presented at trial, Montayne TR. 10241, PX 4640, 4641, Pkg. 8, and Application of GTE to Acquire Control of Telenet, FCC Docket 79-262, Memorandum Opinion and Order, May 11, 1979 ¶ 57.

[25] Plaintiff's response at 44.

[26] See Modification of Final Judgment, *U.S.* v. *Western Electric et al.* Civ. No. 17-49 (D.N.J., Jan. 8, 1982) Appendix B, Section (B)(3).

[27] For example, AT&T is presently under no obligation to implement a national numbering plan providing equality as to the number of digits in the access code used by intercity carriers.

Since AT&T will continue to operate a rate base-regulated toll service monopoly even after implementation of the proposed settlement, it retains the incentive and the ability to engage in anticompetitive self dealing, favoring equipment and supplies manufactured by Western Electric over lower cost and/or better quality general trade products. In addition to the multitude of opportunities Western has to improperly influence purchasing decisions, Western's pervasive involvement in AT&T's procurement system provides it with access to advance planning and other procurement-related information which is either totally unavailable or available only at a much later date to general trade manufacturers. In determining that AT&T's proposal to increase the BOCs' independence in procurement would be ineffective in accomplishing that goal, the Commission took particular note of the fact that "Bell's proposed entity would put 'competitive restraints' on the release of certain information to the General Trade, while Western would continue to have full access to such information." [30]

The proposed settlement places no obligation on AT&T to procure equipment or release procurement-related information on a non-discriminatory basis. Clearly, the Commission must continue to carefully scrutinize and where necessary regulate AT&T's procurement process, so as to ensure that ratepayers receive the benefits which a competitive procurement environment can provide.

Aside from the pro-Western bias which is inherent in certain aspects of Bell's procurement system and the not-so-latent potential for abuse of Western's direct and indirect involvement in the procurement process itself, AT&T will retain the ability to utilize "license contract" arrangements and other unverifiable cost allocation tactics to further impede the development of competition in the equipment industry. The Commission has on several occasions explicitly stated its concern over "the potential harm to a competitive equipment market—and, in turn, to consumers of services provided by that equipment—that the license contract poses." [31]

Absent regulatory requirements which actually reach and alter the inherent incentive of the rate-base regulated monoploy to reallocate as many costs as possible to its monopoly services, and correspondingly, as few costs as possible to its competitive services and goods, the monopoly ratepayers may well pay for services and goods which they do not receive. [32]

While AT&T Long Lines is technically not a party to the license contract agreement, the Commission noted that it "received many of the same services and is billed on an allocative basis similar to that of the participating companies." [33] In fact, the percentage of total gross revenues paid by Long Lines in 1979 under its arrangement with AT&T's General Department was more than twice the percentage paid by the BOCs under their license contracts." [34] Under the proposed Modification, AT&T would remain able to utilize this mechanism to the detriment of its captive ratepayers. A continuation of FCC efforts "to correct the likely misallocation of costs that has been occuring" [35] is clearly in the public interest.

CONCLUSION

Although the proposed Modification, if approved, will effectuate a massive restructuring of our nation's telecommunications industry, it does not (and cannot) resolve all of the competitive problems which have historically impeded the Commission's efforts to discharge its statutory obligation under Section 1 of the Communications Act. In concluding its initial comments in Docket No. 80-53, ITSC noted that the Commission, in attempting to reform Bell System procurement practices, had

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[28] See, e.g. Further Notice of Proposed Rulemaking in Docket No. 79-252, 84 F.C.C 2d 445 (1980).

[29] The Justice Department presented evidence indicating that competitive entry is impeded by the fact that only broad-based entry is viable—the offering of a single route will not suffice. In consequence, capital requirements are extraordinarily large and must be met at considerably higher cost. *U.S.* v. *AT&T*, testimony of William H. Melody, TR. 9319-20.

[30] Report Docket No. 80-53 at 10.

[31] 84 FCC 2d at 272; see also Report Docket No. 80-53 at 20.

[32] 84 F.C.C. 2d at 265.

[33] Id.

[34] Long Lines payments were 5.79%, while the BOCs paid only 2.15%. 84 FCC 2d at 267, Table II.

[35] Report Docket No. 80-53 at 20, citing 84 F.C.C. 2d 259.

"embarked upon an important task." Regulatory oversight of both Bell Operating Company and AT&T procurement is as essential now as it was then. Only through the continued exercise of its own statutory authority during this critical period can the Commission hope to ensure that ratepayers receive the benefits of the best available telecommunications equipment at the lowest possible cost.

APPENDIX A

INDEPENDENT TELECOMMUNICATIONS SUPPLIERS COUNCIL

American Telecom, Inc., Pasadena, Calif. California Microwave, Inc., Sunnyvale, Calif. Farinon Division/Harris Corp., San Carlos, Calif. Ford Industries, Clackamas, Oreg. General Telephone & Electronics, Stamford, Conn. ITT Corp., New York, N.Y. Lynch Communications Systems, Inc., Reno, Nev.

Midwest Telephone Supply, Inc., Appleton, Wis. Phelphs Dodge Communications Co., White Plains, N.Y. Porta Systems Corp., Syosset, N.Y. Reliable Electric, Franklin Park, Ill. Stromberg Carlson Corp., Orlando, Fla. Tellabs Inc., Lisle, Ill. 3M Co., St. Paul, Minn. United States Telecommunications Suppliers Association (USTSA), Chicago, Ill.[1] Valcom Corp., Roanoke, Va. Warren Communications, Livingston, N.J.

Senator CANNON. Next, Mr. W. R. McGrew, State vice president, Central Telephone, Las Vegas, Nev.

STATEMENT OF W. R. McGREW, STATE VICE PRESIDENT, CENTRAL TELEPHONE CO.

Mr. McGREW. Senator Cannon, members of the Senate Commerce Committee, on behalf of Centel I appreciate the opportunity afforded us to appear before you today.

For those of you who are not familiar with Central Telephone and Utility Corp., I have submitted with my testimony a description of Centel, outlining the geographic areas in which Centel has telephone operation, and the areas from which we sell terminal equipment, supply other communications products, and offer cable television service.

Central Telephone, as Centel's largest telephone subsidiary, is in an unusual position in Nevada. Central Telephone and not Nevada Bell is the largest telephone company in the State. Thus we have a special interest in the effects within Nevada that will result from the divestiture by A.T. & T. of its telephone operating company subsidiaries, Pacific Telephone and Nevada Bell.

With about 239,000 customer access lines, the Las Vegas community comprises Centel's largest telephone operating area. Our other Nevada communities add an additional 17,000 access lines. All together, we serve over 500,000 telephones on our Nevada lines.

Our substantive interest in the proposed consent decree is very much like that of any other independent telephone company. We are concerned about its effects on our operation, on the nature of the business, on the long-term growth and viability of local companies in general, and on the future of the nationwide network. Our concerns about the consent decree's effect on the nationwide telephone network are reinforced by the nature of our Nevada location.

Let me spend a minute discussing that network. It is a partnership that connects all telephone companies and promises benefits for investing in the growth and improvement of the communications generally. We have some concern about the survival of that integrated network after divestiture. We are concerned because our rural or more remote exchanges in Boulder City, Searchlight, Blue Diamond, and Henderson, for example, must continue to have a point of connection to transmit calls to other areas of the country, without forcing any customer to make a significant financial sacrifice to place those calls.

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[1] USTSA is an organization composed of over 500 telecommunications equipment manufacturing and supply companies located throughout the United States.

We are also concerned that primarily in urban Las Vegas our local network continues to be utilized by intercity carriers and large customers, and that the intercity investment we have made will not be abandoned, but instead be used as a funnel to bring interstate calls into the local area.

The cooperation among telephone companies has always been good. I do not know of a single case where a contract dispute over cost separations or settlement payments of Centel's had to be placed in litigation or referred to a third party for resolution because the parties could not resolve it satisfactorily themselves. This is itself unusual in an era of litigation. We hope this cooperation will continue.

Our fear is that after the consent decree, and in an atmosphere of increased competition, any economic incentive to cooperate will be lost. Our hope is that other incentives can particularly replace the economic incentives of integration and avoid network deterioration. They can so long as we all recognize that the growth and improvement of one interconnected nationwide network is in the best interests of all of us, regardless of who participates, and the nature of their participation.

There are a number of network issues which in the past were matters of consensus without any formal, codified requirement. In the future, formal guidelines and standards may become necessary to keep the network functioning properly.

Once access charges are instituted by the Bell operating companies, it may not be long before they are adopted by all telephone companies, large and small. A different framework will develop around the access concept. The proposed consent decree recognizes this.

As carriers, we will have to agree on and institutionalize a mandatory nationwide numbering scheme to replace the voluntary plan that is beginning to see variations. We should also institutionalize network transmission standards and create a mechanism for carriers to engage in efficient network planning. These are examples of the kind of network issues that must be considered. There will be other areas where similar uniformity will be necessary which will emerge as time goes on.

Another network issue involves the determination of the new exchange boundaries. As conceived, these will be basic and very important network components for the foreseeable future. We as independents feel it is essential that all industry participants be involved in the process of establishing these boundaries. All the non-Bell telephone companies must be involved in this network planning process since boundaries will affect us as much as the Bell operating companies.

We are moving ahead even now to implement changes that we consider imminent in the marketplace. For example, during the last 4 years, we have taken major steps to reorient our business in the area of terminal equipment marketing. In fact, effective March 1, 1982, our company here in Nevada discontinued the provision of new terminal equipment on a tariff basis. This action was a major step to implement the Federal Communications Commission's Computer II decision in the area of terminal equipment. We have found that our customers are accepting this change with a minimum of misunderstanding or concern.

Centel also recognizes that the changes in the nature of local and long distance markets require that local measured service be encouraged. In this manner, the marginal user will benefit from our rates and the heavy user can be assessed more equitably for the use of our facilities. If we are able to handle the transition to a different environment in a constructive manner, this is essential.

The future of our industry here in Nevada will require the attention and the participation of everyone involved in it, the Commission, the carriers, and the suppliers and customers. We know that the members of the committee are aware of this need, and will cooperate with the industry as the industry's needs for telecommunications legislation evolved.

Thank you, Senator.

Senator CANNON. Thank you very much, Mr. McGrew.

Next we will hear from Mr. William Smith, president, Executone Systems of Nevada.

STATEMENT OF WILLIAM H. SMITH, PRESIDENT, EXECUTONE SYSTEMS OF NEVADA, INC.

Mr. SMITH. Senator Cannon, thank you for inviting me to appear before your committee.

I am the president of Executone Systems of Nevada. We sell telephone equipment and systems to businesses and institutions in competition to Bell here in Nevada and throughout the United States through a network of franchised dealers. Although my company does not believe legislation is needed or desirable now, I think it is valuable and altogether fitting for Congress to be holding hearings such as these to get firsthand input on the implications and impact of the settlement reached between the Justice Department and A.T. & T., and to anticipate future problems before they occur.

It is my belief as a competitor in the telephone industry that the settlement is in the public interest, and that it is certainly in the interest of free enterprise. While implementation is the key to its success, the settlement offers the real possibility of fair competition where it makes sense, while it preserves the regulated Bell operating companies as the proper vehicle for sound local connection for basic telephone service. It does this without asking ratepayers to subsidize its business equipment offerings as they have had to do in the past.

I believe that competition in the marketplace benefits us all, individuals, small businesses, large corporations, utilities, and the Nation as a whole. Because of the pro-competitive potential of the settlement, priority must be given to its proper and prompt implementation in Judge Greene's court. The full judicial process should be allowed to continue unimpeded. Only after this has occurred should Congress consider amending current policies through new legislation.

I am a businessman who has spent my entire 18-year career in the telephone industry, including beginnings with the Bell System in 1964. For 11 of those years, I was a consultant in telecommunications and studied rate matters, the impacts of the Carterphone decision, and other local and national tariff regulations for clients throughout the country.

All of this has always been extremely complex, and yet I have never been so thoroughly confused and ill-equipped to understand where the telephone industry is headed as I am now, and Senator, none of my friends in the Bell System in Washington, in other companies that compete with Bell, in State public utility commissions, not even those people retained to watch this current divestiture process and advise me and others knows either.

Throughout our recent history, Congress has set antitrust regulation. The courts have agreed to a settlement with A.T. & T. based upon those laws. Remember that all that has been agreed to by the Justice Department and A.T. & T. is written on just 13 pages in the settlement documents. There are volumes of detail that must be filled in. Central issues to the settlement, such as assets evaluation and transfer, must be agreed upon.

These are extremely complex issues that will take many months to finally decide. I can envision the current 13-page document outlining the settlement growing into a many thousand-page agreement loaded with specific data about what will happen to each part of the Bell System as part of the divestiture.

Bell is preparing its plan, which must then be submitted to Judge Greene, who will conduct his own review and decide just what in the Bell plan he will accept, and remember, it is possible that he will accept none of the plan, and there will be no settlement. Who can know what the eventual outcome will be?

It is obvious to me that legislation passed by Congress now would be akin to passing laws in a vacuum. Currently, it would be difficult to define the entity to which the laws apply. It is for these reasons Congress should wait. Congress must recognize that suddenly the telephone industry in the United States is a new and largely undefined business, and can only be described now in the broadest and most basic terms. Until a more finite and structured industry is created through the impending judicial process, new legislation carries with it the real threat of inadvertently and accidentally damaging the free enterprise system in the telephone industry that Congress and the Judicial Department are striving to create.

Let me illustrate what I mean through an example. On Monday of this week we saw Representative Tim Wirth's telecommunications bill introduced into the House of Representatives. It provides that the Bell operating companies can continue to offer embedded, in-place equipment to users on a tariff basis for up to 9 years after the enactment of the bill. This clearly contradicts the settlement. Further, the bill provides that the Bell operating companies can begin to market in new product areas after 5 years if not immediately. Isn't this like letting Bell have its cake and eat it too, in contradiction to the intent of the settlement?

I am asking that this committee and Congress as a whole protect free enterprise and competition. My company has grown from 8 people last year to over 30 at the present time. While Nevada Bell is laying people off and offering early retirements, Executone Systems of Nevada is hiring. During the current difficult economic period, we are growing and prospering because we are presenting alternatives to Nevada's business community that it did not have before, and that it needs desperately. Let the judicial process move toward its logical conclusion, and wait to pass legislation when it is really needed.

Senator CANNON. Perhaps, to add to the confusing state of affairs that you have recognized in your statement, I should announce now that Congressman Wirth's House subcommittee today reported out a telecommunications bill which in part would amend the A.T. & T.-Justice Department announced settlement and the vote of the subcommittee was 15 to nothing. Of course, it now has to go to the full committee for consideration.

Next we will hear from Mr. John Holmes.

STATEMENT OF JOHN M. HOLMES, DIRECTOR OF REGULATORY OPERATIONS, PUBLIC SERVICE COMMISSION OF NEVADA

Mr. HOLMES. Senator Cannon and members of the Committee on Commerce, Science, and Transportation, my name is John Holmes and I am employed by the Public Service Commission of Nevada in the capacity of director of regulatory operations.

Thanks to the policy of universal telephone service adopted by Congress in the 1934 Communications Act, nearly all Americans today can afford telephone service. As a result, the Nation's telecommunications system is the finest in the world, and at the lowest cost to its subscribers based on the hours of labor needed to pay for such service.

On behalf of the Public Service Commission of Nevada, I am here to warn you today that unless great care is taken, many Americans will soon be unable to afford telephone service. Furthermore, better service will not come with higher rates. In fact, most residential customers will regard these mandated changes as a degradation of service. We question whether the decree goes too far in setting telecommunications policy in what is basically a two-party proceeding based on antitrust law and not a public interest standard such as is found in the Communications Act of 1934 and similar State statutes.

The decree appears to reflect some of the provisions of pending legislation, such as exchange areas, while ignoring other legislative provisions like affordable exchange rates. I might add at this time that we think that Nevada should be one exchange under the new definition. Many of the decree's provisions are unclear. The language must be considerably tightened to avoid continuing requests for interpretation or modification. The decree goes far beyond legislative and FCC attempts to provide a mechanism to allow A.T. & T. to compete in manufacturing, supplying customer premises equipment, or as we call it, CPE, and offering information services.

It restricts Bell operating companies, known as BOC's, from all of these fields, and limits them to exchange service, and I quote from the decree, the term "natural monopoly service actually regulated by tariff." These restrictions on the BOC's are tighter than the 1956 consent decree was on A.T. & T., and appear to be unnecessary to accomplish the DOJ or Department of Justice goals.

In the competitive impact statement, the Department of Justice states that the BOC must not be organized in a manner that financial or technical viability is jeopardized. That is on page 21 of the CIS. A.T. & T.'s first step was to form seven regions. P.T. & T. and Nevada Bell form one of those. Each of the regions has between $14 billion and $20 billion in assets. Every region had from $800 million to $1.1 billion in earnings, except P.T. & T., which had $439 million last year.

Currently, P.T. & T. has the lowest bond rating of any of the BOC's. It is evident to us that Nevada Bell got saddled with a loser. There are no guidelines for determining the financial condition of a BOC upon divestiture, and no provision for BOC or regulatory input in the reorganization planning process. No mechanism is specified in establishing the value of assets to be transferred from BOC's to A.T. & T. Book value is the implied standard, yet the standard may substantially understate CPE and interexchange equipment value, leaving BOC ratepayers with higher costs for the duration of the transition period that BOC's are given priority with Bell Labs and Western Electric. Prices charged the BOC's should be cost-based, since BOC's will still be captive customers.

Restrictions of the scope of permissible operations of BOC's have already created adverse investor perception of BOC's. These restrictions can be expected to create demands by BOC's for modifications of the decree much sooner than A.T. & T. sought modification of the 1956 decree, unless these provisions are changed now. The language relating to filing of cost based unbundled tariffs by BOC's for exchange access implies elimination of current contributions from interexchange service to exchange service rates. Despite reports in the news media by A.T. & T. and DOJ officials to the contrary, it appears that the divestiture of CPE will reduce contributions in support of exchange rates.

The provision of inside wiring appears to reside with the BOC, but it is not clear under the general logic of the decree. It seems it should be provided by A.T. & T. We feel it should go with CPE to A.T. & T. The cellular radio service provision is not explicit in the decree. The service appears to resemble monopoly exchange service, even if one additional carrier can provide the service. Therefore, the BOC's should provide cellular radio service.

The potential impact of the decree on Nevada Bell subscribers is easily recognized, but there will be a flow-through impact to all Nevada subscribers regardless of which of the other 11 companies serve them. This potential impact comes from the loss in current contributions from interexchange service. This area is unclear in the decree, but DOJ and A.T. & T. officials claim the decree does not preclude a contribution in the access charge.

Until this point is clarified, we believe the effect of the potential loss of this large contribution must be recognized.

I prepared a little table showing rate impact on some of the operating companies in the State. It depicts the loss of interstate revenue support based on the allocation of non-traffic sensitive costs, including CPE.

I will give you the name of the company and then the amount of money describing the monthly increase per main telephone. Nevada Bell, $21; Continental Telephone, $23; Central Telephone, $13; Lincoln County, as John Christian just testified to, is in the neighborhood of $20; Moapa Valley, $9; Rio Virgin, $20; Churchill County, $16; Nevada Telephone & Telegraph, $26.

Now, I would like to look at some operational considerations. Class 4 switches which connect the interexchange network to the exchange network apparently are to be owned by A.T. & T. This, we feel, is a major mistake. It is an anticompetitive, unequal access arrangement which requires constructing expensive, inefficient, duplicate trunking arrangements to serve multiple interexchange carriers. This provision of the decree must be changed or some other major goals of the divestiture plan will be forfeited.

The provision of operator services needs to be clarified. BOC's should provide this function for exchange operator services and offer to provide it for interexchange carriers on a nondiscriminatory basis. Private line services should be provided after divestiture under the same general parameters as exchange-interexchange services.

Language governing provision of CPE for emergencies and provision of coin telephones needs clarification. BOC's should provide all coin telephone service, including the terminal equipment.

Senator, we have identified a substantial number of important concerns in both financial and technical operational areas which question whether the form of divestiture proposed in the decree is in the public interest. If the divestiture of the BOC's is ultimately found to be in the public interest, and we are certainly not convinced that it is, as currently proposed, then many of the problems enumerated in this analysis should be dealt with in the decree itself.

In addition, there appear to be several areas where Federal legislation is needed to establish or preserve important public interest policies, such as maintenance of universal service at affordable rates, fair asset valuation procedures, and regulation of the dominant interexchange carrier as long as public interest requires it.

Finally, prompt FCC or joint board actions will be necessary to avoid the very disruptive transitional effects of the proposed elimination of the separations process, and to classify properly inside wiring on customers premises as a competitive market, subject to deregulation, on terms similar to those applicable to customer premises equipment.

I want to thank you on behalf of the Commission for allowing us to present our views to you. I have submitted our complete formal comments for introduction into the record. This concludes my presentation, unless you have any questions.

[The statement follows:]

STATEMENT OF JOHN M. HOLMES, DIRECTOR OF REGULATORY OPERATIONS, PUBLIC SERVICE COMMISSION OF NEVADA

I. INTRODUCTION

The Public Service Commission of Nevada (PSCN) is a regulatory agency created and existing pursuant to the Nevada Revised Statutes. Among its duties it exercises comprehensive regulatory supervision over telephone utility companies operating within the State of Nevada, including supervision of the adequacy of service and of the rates and charges of communication companies with respect to services provided between points within the States. Chapters 703 and 704 of Nevada Revised Statutes.

Nevada has a substantial interest in the transactions and property which are the subject of the proposed settlement between the United States Department of Justice (DOJ) and the American Telephone and Telegraph Company (A.T. & T.). The State of Nevada and its instrumentalities, subdivisions and residents are significant users of telephone service provided by Bell Telephone Company of Nevada, a wholly owned subsidiary of Pacific Telephone and Telegraph which is itself a corporation 91 percent owned by A. T. & T.

The business of Nevada Bell is that of a public utility affected with a public interest. Its assets were acquired and its revenues are accrued under the purview of regulation by the PSCN. In return for a monopoly right to operate as a public utility, Nevada Bell is obliged to provide adequate, efficient, just and reasonable service, at just and reasonable rates. Nevada Revised Statute 704.040 Nevada's interest in the proposed antitrust settlement is to assure that any reorganization of A. T. & T. will not impair the ability of Nevada Bell to continue to meet its obligations as a public utility and to provide affordable telephone service in Nevada.

The proposed Modification of Final Judgment contemplates a plan for reorganization of A.T. &. T. which includes divestiture of A.T. &. T.'s wholly or majority-owned Bell operating companies in compliance with a series of very generally stated conditions. These generally stated conditions create substantial uncertainty in many critical areas thereby giving rise to the possibility of unnecessary conflict with the Public Service Commission of Nevada's jurisdiction, relative to: (1) abandonment or transfer of utility plant, assets and business rights; (2) issuance of securities; (3) establishment of intrastate toll rates; and (4) the duty to insure provision of adequate service at reasonable rates.

The PSCN's analysis attempts to focus on the following concerns for the purpose of clarifications or resolutions of them so that we may accomplish the basic goal of assuring the availability of affordable telephone service through financially sound regulated companies.

II. GENERAL CONCERNS

A. Where should national telecommunications policy be made?

The Decree, goes far beyond the traditional antitrust role of assuring fair competition in an already competitive unregulated industry. The nationwide scope of the Bell System and the public interest nature of telecommunications services makes the Decree a massive force in determining national public policy in the field of common carrier telecommunications. Such broad policy making should come from Congress, where attempts to do so are in the making. Much of that effort is preempted by the Decree, unless Congress acts to overturn some or all of its provisions. The direction which the Decree pushes telecommunications policy is predicated solely on the antitrust standards of Federal Law, not on the public interest standards of the Communications Act of 1934 and the similar state statutes throughout the country. In deciding to agree to divestiture, AT&T officials concede that the direction in which legislative activity was pointing was less desirable from their point of view. The legislative inclination is much more clearly directed toward preserving the basic exchange and interexchange telephone system as an efficient and affordable national asset, while permitting a mechanism for expanding the Bell Systems' competitive opportunities, rather than the other way around. A similar approach is being followed by the FCC in its recent proceedings, including most notably the Computer II Docket. In fact, there seems to be a three-way race between the Courts, Congress and FCC to see who can be first in dismantling our current national telecommunications policy. More disconcerting is the fact that all three are going in slightly different directions.

B. The decree appears to assume some legislative changes already under discussion while ignoring others

The Decree's definition of exchange/interexchange boundaries closely parallels those in S. 898 and in the proposed H.R. 5158. On the other hand, there is no mention of any concern for or mechanism to assure the affordableness of basic exchange telephone service. The Decree, however, is quite detailed in spelling out requirements for BOC's to file cost-justified, unbundled tariffs for services in a rather short time frame. FCC is considering a five-year phaseout of certain cost allocations to provide a smooth transition.

C. Many provisions are unclear

There seem to be dozens of different interpretations given to important provisions affecting the equality of access, the availability of mechanisms to keep exchange rates affordable, the specific services and facilities provided by BOC's (or AT&T) and the size of exchange rates. The DOJ's Competitive Impact Statement (CIS) adds to the confusion by interpreting some areas far differently than our own analysis would indicate. These provisions and others must be clarified in revised, much more explicit Decree language or endless litigation will result in an uncertain operating environment for the industry for years to come.

D. The Decree appears to give AT&T the profitable assets and growth potential while giving BOC's the less rewarding aspects of the business

AT&T is free to engage in unregulated manufacturing and the provision of information services heretofore prohibited by the 1956 Decree. It is also allowed to compete for exchange service customers either directly or indirectly by siphoning off large profitable chunks of business for individual corporte customers. The BOC's, however, are prohibited from competing with AT&T for customer premises equipment, interexchange service, manufacturing, information services (some of which are now being provided by BOC's) or any service not a "natural monopoly service actually regulated by tariff." This unreasonably restricts the BOC's performance in the telecommunications marketplace as a viable entity.

Published figures show that $80 billion of A.T. & T.'s $120 billion will be divested. That represents ⅔ of the assets, but those assets generate only ½ of the revenues. State regulators see $20 billion in assets being dumped in their laps that are not covered by an adequate intrastate rate-of-return.

III. GENERAL FINANCIAL CONSIDERATIONS OF THE DECREE

Consumers and state regulatory bodies are most concerned about the potential impact of the Consent Decree on local exchange rates. This concern arises from the numerous interpretations that can be attributed to the terms and conditions of the proposed Decree. The purpose of the following analysis is to point out those areas of the proposed settlement which are unclear and require further amplification, issues that are clear but may have a negative impact upon local exchange rates, items which are clear and essential, and finally, some concerns of ours which have not been addressed by the Decree.

In addition, an estimate of the impact of the Decree on local exchange rates is provided in the following section. It must be borne in mind throughout this analysis that although sharp increases (over 200 percent in Nevada) in local exchange service rates could result from the agreement entered into by Justice and A.T. & T., it is likely that price decreases and new innovations will result in the competitive areas of telecommunications equipment, customer premises equipment and interexchange and information services. These benefits are the ones sought by the Department of Justice. We do not deny their likelihood, but we fear the cost to utility service subscribers for these competitive gains may be (1) inadequately considered and (2) potentially too high to justify a defining that the decree, as proposed, is in the public interest.

A. Terms of the decree which are clear but objectionable

Section I (A).—A.T. & T. must submit to the Department of Justice a plan for the completion of the required reorganization within 18 months after the effective date of modified judgment. We feel that 18 months is insufficient time to complete such a monumental task.

There are no guidelines for the financial condition of the BOC's at the time of divestiture. More important, there is no provision for recourse by the BOC, or its regulators, if the financial condition is considered unfair or unsatisfactory for any reason. It appears that the specifics of the reorganization will not be known for six months after the Decree is "entered". The plan will be subject only to DOJ's approval, and comment or modification by outside parties will not be allowed. In the Competitive Impact Statement, the department of Justice states that the BOC must not be organized in a manner that financial or technical viability is jeopardized (CIS page 21). A.T. & T.'s first step was to form seven regions. P.T. & T. and Nevada Bell form one of those. Each of the regions has between $14 and $20 billion in assets. Every region had from $800 million to $1.1 billion in earnings except P.T. & T. which had $439 million last year. Currently, P.T. & T. has the lowest bond ratings of any of the BOC's. It is evident that Nevada Bell got saddled with a loser. No provision is made for formula BOC or regulatory participation in this decision-making process. Full participation should be provided.

The Decree gives no indication as to who is responsible for the administrative cost of accomplishing the divestiture. It seems that A.T. & T. shareholders should pay this cost. Certainly none of this cost should be borne by monopoly ratepayers.

Section I (A) (2).—No reference is made to the authority of Federal and State regulators in determining whether book value, market value or some other valuation standard should be employed in assessing the worth of transferred assets. The Decree seems to imply that a book value standard should be used. This may significantly understate the value of interexchange and terminal equipment assets, leaving BOC ratepayers with higher costs. The determination of the depreciation reserve associated with each plant account must also be made by regulatory authorities.

Section I (C).—AT&T, Western Electric and Bell Telephone Laboratories are directed to provide to any BOC, on a priority basis, all research, development, manufacturing and other support services are needed. There is no mention that these services should be provided on a cost justified basis. In addition, we want to be sure that prior license contract payments by the BOC's for the development of on-going exchange and non-exchange related projects will be taken into consideration so that when the BOC's make future purchases from Western Electric, the price of facilities will reflect the fact that a portion of the research and development has already been paid for. On the other hand, the BOC's could be reimbursed now for such expenditures. There is no provision to assign any of the prior patent rights or to provide for any of the royalty benefits associated with those patent rights to the BOC's. If the BOC's should be permitted to engage in manufacturing, they should have access to all patents which existed prior to divestiture.

Section II (D)(1)(2)(3).—It is unbelievable that the BOC's are prohibited from providing anything but exchange telecommunications services or natural monopoly service actually regulated by tariff. The Decree does not define what natural monopoly service actually regulated by tariff. The Decree does not define what natural monolpoly telecommunications services are or what happens should such services eventually become competitive. We feel that separate subsidiary safeguards and regulatory oversight can prevent cross-subsidies or anti-competitive practices when regulated companies are also engaging in unregulated activities.

The intent of the Decree is to promote competition and so we are at a loss to understand why local telephone companies, who have long provided equipment and interexchange services, and who have the expertise to continue to do so, should be defined the opportunity to enter these or other competitive telecommunications or information service fields through separate subsidiaries. If these opportunities were available to the BOC's, it would promote further competition, potentially prevent market dominance by the surviving AT&T company, permit BOC's to grow in the future and avoid the problems inherent in the 1956 Consent Decree which have already denied the public many technological innovations, new services or lower prices. Other telephone companies, including Centel in Las Vegas, which is larger than Nevada Bell, are already into these fields.

Another field in which the BOC's should be permitted to broaden their base of operations is that of certain enhanced services uniquely suited to provision through the exchange network. Prime examples are call forwarding, call waiting, and other "custom calling" answering services. Currently, Nevada Bell receives over $622,000 yearly from the sale of these features. These are all products of ratepayer-funded Bell System research and development; all have existing or potential markets; and all represent technological alternatives which may have to be abandoned if it is forbidden to offer enhanced services through the local network.

This restricted market of the BOC's will increase the cost of debt and equity capital for them. Several news stories have spoken to this result and Moody's Bond Survey of January 12, 1982, hints that at least some BOC's will be downgraded. Personal Finance, in its February 3, 1982, issue tells readers to hold your AT&T shares until after divestiture, then sell the operating company portion because their growth will lag behind AT&T. A letter to Judge Greene from the Treasurer of the

State of South Carolina expresses concern over the impact on the financial soundness of its retirement system. It seems that the state is a substantial holder of the debt obligations of the local operating company. This investor perception of the BOC as a "low earner" is further solidified by AT&T's apparent ability to compete with the BOC for exchange services or for services which will bypass the exchange network altogether. In the future, the BOC's will find themselves in the same predicament which AT&T complains about today. The 1982 Consent Decree will allow competitors into the BOC's business but keep the BOC's out of theirs.

B. Ambiguous items requiring clarification

Section II(A), Appendix B(A)(1), Appendix B(B)(1), (2), (3).—These sections call for the provision of exchange access on an unbundled, tariff basis that does not discriminate against any carrier or other customer. The access charge tariffs are to replace the division of revenues process and must be cost justified. Any differences in charges to carriers must be cost justified on the basis of differences in services provided. However, Appendix B(B)(3) states that access charges should be equal per unit of traffic delivered or received for all interexchange carriers with minor exception. The meaning of these conflicting conditions is unclear. Our position on this portion of the Decree depends heavily on the interpretation associated with each of these sections. We also question the parties' (DOJ and AT&T) authority to put these particular parameters into tariffs, when normally federal and state regulators determine such matters.

The following items are of utmost concern in assessing potential impacts of the proposed Consent Decree: the meaning of "cost justified"; the meaning of "unbundled basis specifying each type of service, element by element"; whether an exchange boundary can include the entire state; whether exchange access charges can include contribution to local exchange services; whether they may do so only until September 1, 1991, as may be provided for in Appendix B(B)(3); whether FCC regulates the access charges for interstate traffic, and if in doing so, retains jurisdiction over certain BOC costs, thereby continuing the need for a jurisdictional cost separations process; what will be the settlement format for Nevada Bell and Independents under the new definition of intraexchange traffic; and, exactly what constitutes interexchange traffic. We strongly object to any plan that would abruptly deprive local exchange rates of the acknowledged contribution currently received through the division of revenues process. The Decree should clearly state what effect it has, or is intended to have, on this contribution, both immediately and in the longer run.

Under the current separations and settlements procedures, a portion of terminal equipment is subdivided between the inter- and intrastate jurisdiction. However, since equipment will not longer be provided by the BOC's, there is no clause allowing the continued contribution to local exchange now available through the separation of terminal equipment. If the current level of contribution is maintained through access fees, and this is implied within the Decree, many of our concerns related to the local exchange ratepayer might be satisfied. However, it would be pure folly to think that carriers would be willing to pay that rate to access our sparsely populated areas which have historically had a 65 to 70 percent contribution. (State average—all companies) Bypassing the network via satellite would be very easy. Without clear direction from the Decree, this item is left open to imagination and interpretation.

Section IV(E).—The definition of customer premises equipment is ambiguous since it does not specify whether inside wiring is included. Since it is DOJ's intent to place competitive services with AT&T and since inside wire is optionally owned by either the utility or the customer in Nevada, we feel it is appropriate, under the terms of the agreement, to transfer these costs to AT&T. The point of demarcation between the BOC and the customer should be at the protector for both residential and business installations.

Section IV(G).—In this section our concern is the definition of an exchange or exchange area; which long distance services will remain with the BOC's; and which services will be assigned to AT&T (Long Lines). We have seen definitions of exchange areas which run from encompassing an entire state to encompassing a single central office. Of great concern is the fact that no mention is made of the treatment of independent telephone companies either for toll purposes, for separations purposes or for inclusion or exclusion from exchange areas.

The final interpretation of exchange area will impact such issues as extended area service, message unit calling and the opportunity to redefine exchange areas later. Not only is this matter critically important to the local exchange ratepayers, but it also determines which facilities and services will remain with the BOC and which will be transferred to AT&T. It must definitely be clarified. We feel that the unusual characteristics of Nevada dictate a single exchange area encompassing the entire State.

C. Terms of the decree that should remain

Section A(1).—Adequate technical expertise and facilities must be available to the BOC's in order for them to function as separate entities.

Section A(3).—The license contract agreement must be replaced by cost based charges for services rendered to each BOC on a divested basis. The BOC's ability to establish a centralized organization [Section I(B)] for engineering, administrative and other services to replace functions provided by AT&T is a desirable aspect of the Decree.

Section I(C).—The BOC's have always been dependent upon the expertise of AT&T. An abrupt termination or lack of availability of these services would not be in the public interest. The stated priority basis and phaseout period are desirable.

Appendix B.—There can be no dispute that equal access to the local exchange for all OCC's is mandatory. Our reservations focus on the cost to subscribers either in exchange or interexchange rates to accomplish this objective. Allowing the BOC's to bill customers for the use of interexchange services is desirable, since it will enable BOC's to continue efficient use of their billing and computer systems. However, questions arise concerning who terminates a customer's service and for what reasons termination may occur.

C. Items not addressed

Radio services.—Communications services such as paging and mobile telephone service are not addressed by the settlement. Both the terminal equipment and (non-cellular) transmitter facilities of current radio-telephone services provided by BOC's are highly competitive and do not constitute "natural monopoly services". The Consent Decree does not address the disposition of these services. Cellular radio telephone service, however, appears much more like exchange service, and it probably will exhibit monopolistic tendencies for the near future even though there may be two providers. We believe that a firmer definition of the future treatment of radio telephone service must be contained in the Decree. Our main concern is that the BOC's be allowed to compete in this area.

Billing for Terminal Equipment.—The Decree does not permit the BOC to bill, even on an interim basis, for terminal equipment provided to customers of AT&T. Bell has expended millions of dollars in establishing computer billing systems and a customer record data base primarily because of the multitude of terminal equipment services. The terminal equipment portion of the billing system and computer capacity are an integral part of all other billing information for exchange services. To require AT&T to establish a parallel record system would be a waste of resources. This was recognized by the FCC in its Computer II Order where the local operating companies would continue to provide and bill for embedded equipment. The BOC's should be permitted to continue billing for embedded equipment and in turn charge AT&T a cost base fee for the service. In fact, the BOC's billing process could be a highly marketable service for any type of business

D. Other concerns

Because of the required reorganization, local operating companies will be left with idled facilities and resources. For example, BOC's are currently staffed to process customer orders for complete telecommunication service. The Decree will cause duplication of some of these functions by AT&T or the OCC's. The BOC's should be permitted to enter into nondiscriminatory agreements to provide order handling, billing or other services that will utilize fully their capacity and staffing, otherwise there will be a mismangement of resources and a waste of consumer dollars.

IV. POTENTIAL IMPACT OF THE DECREE ON NEVADA BELL'S LOCAL SERVICE RATES

The divestiture mandated by the Consent Decree and the restrictions placed on Bell Telephone Company of Nevada, and its parent Pacific Telephone and Telegraph Company, will trigger an extensive reorganization affecting the cost levels of every part of its operation. The Decree's many unknowns make it impossible to determine accurately the eventual impact on local service rates. In order to provide an estimate of the overall local service rate impact of the Decree, a few of the major areas within Nevada Bell's operation were isolated and the impact quantified for each under the most likely scenario. Unfortunately, in some cases no definite impact could be determined.

The major areas of potential impact are: 1. Western Electric purchases; 2. Directory advertising; 3. Administrative costs; 4. Cost of divestiture; 5. Jurisdictional separations; 6. Customer premises equipment; 7. License contract; and 8. Cost of debt and equity.

Each of these areas is discussed separately in the remainder of this section.

The primary purpose of the impact analysis is to recognize the potential effect of the Decree on Nevada Bell's local sevice rates. Although not directly affected in the same degree, the remaining 11 Nevada telephone companies will also experience an impact. The potential impact on the independent companies lies in the toll (interexchange) portion of their business. The independents are in partnership with Bell System in the provision of toll service, receiving "settlement" designed to reimburse them for costs incurred in the provision of toll and other interexchange services.

Upon divestiture, this partnership would be dissolved. Instead, each independent would have to negotiate an agreement with each interexchange carrier of file an exchange access tariff. This change will affect its overall level of toll revenues. Furthermore, the effect of the Decree on jurisdictional separations will reduce the amount of settlements that each independent might derive through its negotiated agreements or exchange access tariffs. Intraexchange traffic will also have to be individually negotiated based on the new definition of exchange bound[illegible]s (i.e., there are four (4) serving companies in Clark County alone).

An estimate of the impact of the decree on some independent telephone companies is included (Attachment A). Many independents derive a significant portion of their revenues through toll settlements (over 80 percent in one instance in Nevada). The potential impact upon the local service rates of these companies will be severe. This should be carefully considered in determining whether the Decree is in the public interest.

No estimate of the cost to BOC's to provide equal access is made because the proposed terms of equal access are in need of major change. Whatever the cost of equal access, we would expect that cost to be assessed to interexchange carriers through access charges.

Western Electric purchases

In 1980, Nevada Bell purchased approximately $39,336,000 in equipment and services from Western Electric, the manufacturing arm of the Bell System. A large portion of this relates to non-terminal equipment and is representative of the company's post-divestiture annual expenditure levels. This is the amount subject to any future Western Electric price changes.

Western Electric's prices for non-terminal equipment are approximately 20 percent below the lowest priced equivalent equipment offered by other suppliers. Western Electric could increase its prices to those of its nearest competitors (or even higher) and still remain competitive. Such an increase would raise Nevada Bell's equipment purchase costs considerably. Furthermore, since Nevada Bell is a captive customer of Western Electric for a significant portion of its purchases (i.e., replacement parts or expansion of existing equipment), Western could raise its prices above the levels charged by other suppliers.

In pre-divestiture times, regulators could guard against such unwarranted price increases by refusing to pass them on to ratepayers. An excess profit made by Western Electric on sales to Nevada Bell could be removed from their earnings. After divestiture, however, this profit-limiting process would be lost to the regulators. The equipment purchase costs actually incurred by Nevada Bell would have to be recognized, unless it could be shown that the company could have purchased its products at a lower price from another supplier.

While Western's pricing decisions are unknown, it appears possible that prices could quickly rise to at least the level of other suppliers, thereby increasing Nevada Bell's annual costs. The company could not totally purchase elsewhere for a considerable period of time. Thus, the Western Electric profits would still be due to its prior relationship with the BOC, and not to its inherrent efficiency in a truly competitive market. We suggest that Western's profit on sales to the BOC's be regulated until September 1, 1987 and that priority be given to meeting the needs of the BOC's.

Directory advertising

In 1980, Nevada Bell received $3,894,261 in revenues from directory advertising. Although the Decree does not specifically address the directory operation, it is the widespread interpretation that only the White Pages portion would remain with the BOC. The Yellow Page operation would go to AT&T after the divestiture. The DOJ's CIS outlines a scheme for providing revenue from yellow pages to the BOC, but it is an unclear and convoluted method.

The overall directory operation is extremely profitable, with most of the profits coming from the sale of Yellow Page advertisements. The profits have been used to defray the costs of other services provided by the company. Loss of any of these directory profits through divestiture would necessitate local service rate increases.

Administrative costs

Nevada Bell is currently organized and staffed to perform several administrative functions common to the exchange, interexchange and customer premises equipment (CPE) operations. Upon divestiture of the interexchange and CPE portions of its business, the company will still be required to perform these administrative functions for its remaining exchange operation.

The company probably would not be able to save an appreciable amount of the costs of these functions upon divestiture. We feel the cost of performing these administrative functions for just the exchange operation will be nearly the same as performing those functions for all three operations combined.

One of the largest indentifiable administrative functions performed by the BOC today is its revenue accounting function. The company bills its customers then collects and accounts for revenues received for all three service categories. A portion of these costs are borne by the interexchange and CPE operations, and the remainder is paid by exchange users. After divestiture, the entities providing each service will be responsible for their own billing operation. While there may be some decrease in the local revenue accounting costs after divestiture, all of the remaining costs will be borne by the exchange operation alone. This results in an increase in administrative costs to the exchange users.

There will be a similar affect on other administrative functions such as personnel and public relations. The costs of these functions are currently shared by all three service categories, as we said before, the cost may be somewhat less after divestiture, but the loss of the ability to share these costs with the interexchange and CPE operations will result in increased costs to the exchange operation.

The financial impact of divestiture upon the BOC's administrative costs is difficult to quantify and is shrouded in uncertainty by the Decree itself. The Decree allows the BOC to continue to provide the billing function for interexchange services after divestiture. The agreement specifically addresses billing for the interexchange operation but is silent on billing for CPE services. We hope Nevada Bell/ Pacific Telephone will come to some sort of agreement with AT&T and continue to provide interexchange billing. Thus, the company will have the opportunity to reduce the adverse impact of divestiture by contracting out its established billing function not only to interexchange carriers, but also to other non-related businesses.

Divestiture costs

There will certainly be additional costs associated with the divestiture itself. These costs (legal, organizational restructuring, creation of new centralized operating company organization, etc.) are of non-recurring nature and most likely will be incurred over the next 18 months (the maximum time allowed for divestiture). We feel the cost of divestiture should be borne by AT&T stockholders, not the ratepayers. Otherwise, with a historical test year in Nevada, Bell could seek to recover these costs during a general rate proceeding.

Jurisdictional separations

Nevada Bell provides services and facilities that are common to both the provision of exchange services and interexchange services. Intrastate interexchange services are regulated by the Public Service Commission of Nevada (PSCN) and interstate interexchange services are regulated by the Federal Communications Commission (FCC). The FCC, in cooperation with state regulators, has established cost allocation procedures used to allocate costs to the interstate interexchange jurisdiction. This allocations process is commonly referred to as "separations". The current separations procedures allocate 60 percent of Nevada Bell's local distribution costs to the interstate interexchange operation. This portion of the company's costs of hooking up its subscribers to the telephone network (including the cost of customer premises equipment and the lines to the local switching office) are allocated to interstate, and are paid for through interstate toll and other revenues. In this manner, interstate toll provides a "contribution" toward the costs of the local distribution facilities. This contribution has enabled the PSCN to hold down the price of the basic exchange services.

With growing competition in both the customer premises equipment and interexchange markets, the FCC is taking steps to modify the current separations procedures to accommodate competition. One proposal will phase out the interstate allocation of customer premises equipment over a five-year period beginning January 1, 1983. This is expected to receive approval and in addition, we predict that the interstate allocation of the remaining local distribution costs will be significantly reduced in the future. The effect of these changes is a gradual transfer of costs from the interstate to the intrastate jurisdiction. In the future, customers will pay these costs in their monthly basic exchange rates rather than in toll charges.

The Decree accelerates these separations changes and will cause more rapid increases in local service rates, to the extent that they are not offset by access charges.

The impact of the Decree upon separations can be divided into two segments; customer premises equipment and non-CPE local distribution.

Customer Premises Equipment: The Decree requires the divestiture of all CPE within 18 months whereas FCC is proposing a five-year phase-out. It is logical that the interstate allocation of CPE costs must cease concurrently with the elimination of CPE from the company's operations. Therefore, the Decree can only be held responsible for the acceleration of the phase-out.

At 1980 cost levels, the elimination of the interstate CPE allocation would reduce the interstate contribution by $9.5 million and, thereby, could cause an equivalent basic exchange service rate increase.

Non-CPE Local Distribution: In 1980, Nevada Bell allocated $30.5 million of local distribution costs to interstate in addition to the interstate allocation of CPE costs. This level of contribution most likely will be diminished through future FCC separations changes. Such a reduction would be spread over many years and have a gradual impact upon local service rates.

The Decree does away with the separations process as it now exists. Instead of allocating costs to interstate and recovering them through a share of interstate revenues, Nevada Bell would directly bill interexchange carriers for the use of its exchange facilities through a series of "access charges". The Decree requires that these access charges be "cost justified" and be separately stated or "unbundled", for each exchange access service provided to each interexchange carrier.

The Decree's reference to "cost justification" is interpreted as a discontinuation of the current separations method which is largely a judgmental allocation process and is not supported by "cost justification". Thus, it appears that the existing annual contribution level of $30.5 million would not be allowed to continue.

Customer premises equipment

The Decree mandates the removal of customer premises equipment (CPE) from Nevada Bell's operation. The CPE portion of the business would be run by AT&T after divestiture.

The impact of Nevada Bell's loss of its CPE business on local service rates is a function of CPE revenues and costs. If the CPE revenues exceed CPE related costs, the loss of the business would adversely impact the remaining operation.

In Nevada Bell's 1981 rate case, studies indicated that CPE was fully compensatory. Divestiture would therefore deprive the company of this contribution.

License contract

Nevada Bell has paid AT&T for services rendered under an agreement commonly called the "License Contract". The payments are advice and assistance from AT&T's General Department and for basic research and systems engineering work performed by Bell Laboratories, the research arm of the Bell System.

Divestiture would eliminate the opportunity for AT&T to pass along to the operating companies expenditures upon non-operating company operations (e.g., enhanced service development).

Cost of debt and equity

Capital costs also will be influenced by the divestiture. Equity costs and the cost of new debt would be dependent upon a myriad of presently unknown variables including the organizational and capital structure of the Bell operating companies and the investors' perception of the risks associated with the exchange business. No estimate of the probable effect upon these items can be made at this point.

It should be noted that Nevada Bell's parent, PT&T, has the lowest bond rating in the Bell system, and this was given under the "umbrella" of AT&T. It seems logical then that unless there is a significant improvement in PT&T earnings, these ratings will fall further after divestiture. The cost impact of these poor ratings will be reflected in Nevada Bell's operation, because no matter how well it performs, it represents only 3 percent of the total of the two companies.

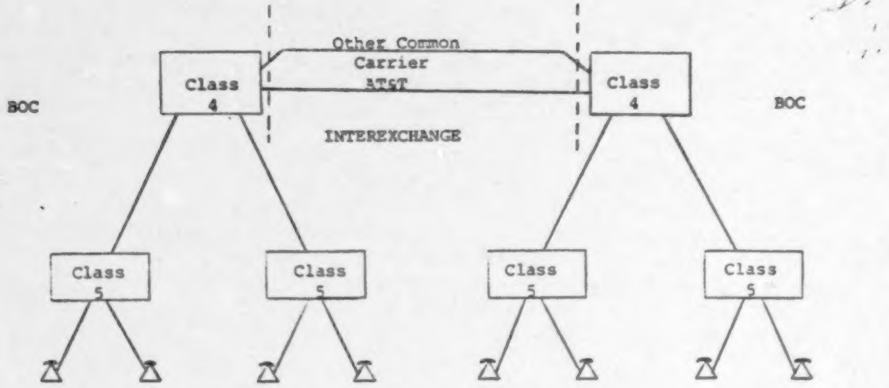
V. OPERATIONAL CONSIDERATIONS

A. Equal access

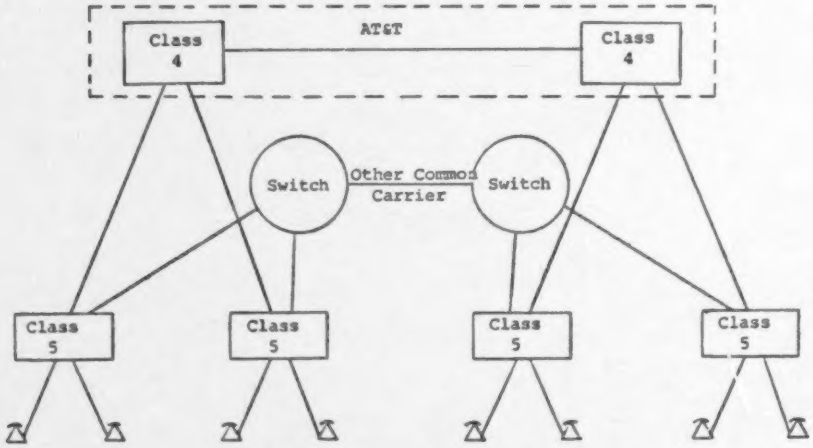
1. *Ownership of the "class 4" switching offices.*—The Decree raises substantial questions regarding the ownership of the "Class 4" switching office. The "Class 4" switching office is the network switching point at which traffic originated by customers in the "Class 5" end offices is concentrated and delivered to trunks which carry that traffic to the rest of the world. Traffic coming to an exchange from the world is delivered to the "Class 4" point and distributed to the "Class 5" end offices and their subscribers. The "Class 4" switch establishes a connection between trunks from end offices in the exchange, and trunks that ultimately go to another exchange. (See Figure 1).

The situation is clouded by the fact that "Class 4" operation is provided in switches which also perform other switching as well. There are 8 installations in Nevada where both the "Class 4" and "Class 5" local switching functions are contained in one machine. (See Figure 2). There is one location where the "Class 4" function is combined with "Class 3" toll network functions in the same unit. Thus, in all but 2 switches in Nevada, it will be impossible to separate out and identify the hardware which represents the "Class 4" machine. Further clouding the issue, is the fact that the majority of the "Class 4" function in Nevada is performed by independent companies.

FIGURE I


Other Common
Carrier
AT&T
BOC
Class
4
INTEREXCHANGE
Class
4
BOC
Class
5
Class
5
Class
5
Class
5

Access Arrangements if
BOC Owns Class 4 Switch

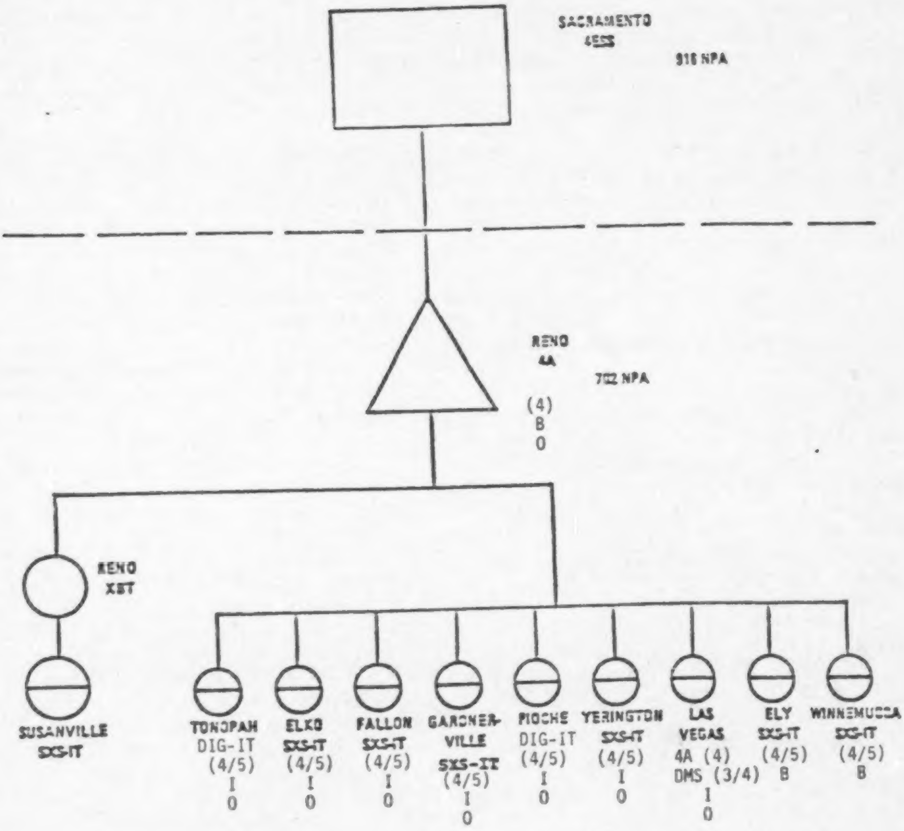

Class
4
AT&T
Class
4
Switch
Other Common
Carrier
Switch
Class
5
Class
5
Class
5
Class
5

Access Arrangements if AT&T Owns Class 4 Switch
Trunks and Switching Facilities Duplicated

FIGURE II

702 NPA

PRESENT CONFIGURATION


SACRAMENTO
4ESS
916 NPA
RENO
4A
702 NPA
(4)
B
O
RENO
XBT
SUSANVILLE
SXS-IT
TONOPAH
DIG-IT
(4/5)
I
O
ELKO
SXS-IT
(4/5)
I
O
FALLON
SXS-IT
(4/5)
I
O
GARDNER-VILLE
SXS-IT
(4/5)
I
O
PIOCHE
DIG-IT
(4/5)
I
O
YERINGTON
SXS-IT
(4/5)
I
O
LAS VEGAS
4A (4)
DMS (3/4)
I
O
ELY
SXS-IT
(4/5)
B
WINNEMUCCA
SXS-IT
(4/5)
B

4 = Class 4 Office
4/5 = Class 4/5 Office
3/4 = Class 3/4 Office
I = Independent Company
B = Bell Company
O = Operator Center

At the present time, BOC's use switches in larger exchanges to route local traffic from one "Class 5" end office in the exchange to another "Class 5" end office in the same exchange. There are economic efficiencies in such an arrangement. The same amount of traffic can be carried on fewer combined use trunks than would be required if the intermediate switch point were not used. Under the reorganization called for in the Decree, such intermediate, or tandem, switching capability will have even more application, because the new definition of exchange areas is larger than it is currently.

Section IV, Para. F, of the Definitions in the Decree states: "Exchange services for exchange access shall not include the performance by any BOC of interexchange traffic routing for any interexchange carrier." We understand this to mean that the BOC is prohibited from performing any switching function at the interface between the BOC and the interexchange carrier, the "Class 4" office. This situation will be costly and inefficient from the standpoint of both the BOC and the interexchange carriers.

If the existing "Class 4" switching points, which perform this interface function, belong to AT&T, as the Decree requires, then the BOC has no physical point at which to offer equal access to its exchange network for other carriers except in the "Class 5" end offices themselves. This would require the construction of additional trunks from each end office to the other carrier's location, duplicating the trunk field already existing to serve AT&T traffic. It would also mean that local tandem switching heretofore performed in some of these interface switches ("Class ⅘") could only continue if additional trunking and perhaps tandem switching equipment was provided by the BOC. (See Figure 1).

A fundamental principle of telephone engineering is that a single large trunk group is a more efficient way to carry a given amount of traffic than several small groups. The language of the Decree appears to require that existing, efficient trunking arrangements in the local exchange must be broken down into smaller, less efficient trunk groups. It also means that while AT&T would have access to the BOC's local exchange network at a single efficient point where the BOC's deliver trunks to the "Class 4" switch, the other carriers will have inefficient access only at the end offices. This type of "equal" access makes no sense whatsoever.

Operator services do not appear to be addressed directly in the Decree. The provision of these services is tied directly to the problems associated with the "Class 4" switching offices. Nevada Bell's operator services today is provided by a computerized system called TSPS (Traffic Service Position System), which is directly connected with the trunks at the "Class 4" switch. If this switch were transferred to A.T. & T., the TSPS and its operator function logically would have to go with the switch to A.T. & T. This would leave the BOC without any operator capability, although it would still have to deal with local exchange access and emergency assistance calls. The operating problem could be solved either with some form of operating agreement with A.T. & T., or by having the BOC provide a new, duplicate local operator unit. However, the most sensible solution seems to be to leave the existing operator function with the BOC where it has the ability to provide local assistance and also offer operator services on an equal basis to all interexchange carriers. Similar concerns apply to the Directory Assistance operator service, since this function is also provided through the "Class 4" switch.

The purpose of the Decree is to separate the local exchange monopoly service from the competitive interexchange carriers. Strict interpretation of this language appears to require an unnecessary duplication of trunking between "Class 5" end offices and local tandem switching points. It may also require construction of additional, unnecessary local tandem switching points to provide "equal" access for non-A.T. & T. interexchange carriers. Such construction would create additional costs for both the BOC's and the non-A.T. & T. interexchange carriers.

Defining the interface point between the interexchange carriers and the BOC's as being at the exchange side of the interface or "Class 4" switch as the Decree does, results in costs and complexities which are totally unnecessary, are a detriment to telephone users, and contribute nothing to the antitrust goal of cost efficient equal access.

If this definition stands, it will virtually preclude the provision of "equal access" for all carriers, since A.T. & T. will have access via its embedded "Class 4" switch and the BOC's embedded trunks to that switch, while access for all other carriers will be provided with new trunk facilities and perhaps new "Class 4" type switching equipment. The costs and, of course, the rates for access, using this new investment, would be higher than for the use of embedded investment. This places the other carriers at a competitive disadvantage. In addition, cumbersome leasing agreements would be necessary between the BOC's and A.T. & T. for the provision of such functions as operator services or switching in "Class 4/5" offices. This would generate huge costs by both the BOC's and the interexchange carriers for facilities which unnecessarily duplicate those already in place. The public will ultimately pay those costs through its payments for toll and local telephone service.

A far better solution would be to define the interface point as the intertoll trunk side of the switch which performs the "Class 4" function, and let ownership of the "Class 4" switch at the interface remain with the BOC's. In this way, the BOC's can continue to engineer and operate the local exchange network in the most efficient manner, and the BOC's can provide equal exchange access to all carriers. Duplicative facilities would be minimized, and the need for complex operational and financial agreements would be eliminate. The objectives of the Decree would be met, and the public's total payments for telephone service would be minimized.

2. *Phased in equal access provisions.*—The requirement for equal customer access to all carriers by a uniform access code will require the introduction of a multi-digit code in place of the existing single digit now used for toll access. The cost implications of such an arrangement are significant. In stored-program switching machines, a translation modificaiton will be necessary to recognize the new codes. In electromechanical switching units, the existing registers will have to be replaced or modified, since they generally cannot accept more than eleven total digits. Additional registers will be necessary to accommodate the increased dialing time for interexchange calls.

We are particularly concerned that all of the costs associated with the provision of equal access be charged to the interexchange carriers and not to the local exchange subscriber. These costs will include provision of additional equipment to handle the traffic requirements of multi-digit access codes; costs associated with any necessary office modifications; and costs associated with premature retirement of existing units that might be required to provide "equal access" to all carriers.

B. *Customer contact complications*

Under the proposed structure, a customer may have to deal with A.T. & T. for terminal equipment, and perhaps inside wire, the BOC for exchange service, and either A.T. & T. or another carrier or both for interexchange service. The customer may be required to contact each of these organizations separately to obtain the service and to coordinate installation. The same would apply to repair service. If the customer cannot initially determine which component is faulty, he will have to coordinate troubleshooting and repair efforts with these various organizations. This is a very negative aspect of divestiture.

Our experience leads us to believe that the equipment provider, the local exchange carrier and the interexchange carrier, may not have a great incentive to cooperate with one another in the coordination of the repair effort. They will more likely point at each other as the BOC, customer premises equipment vendors and radio-telephone companies do currently.

This condition will cause increased customer complaints with regulatory agencies in an effort to force compliance. Service to customers will be diminished, and, at least indirectly, they will pay for these coordination efforts or breakdowns. If the court permitted competing carriers to offer terminal equipment or interexchange services without requiring divestiture, a customer could chose to cope with these problems or to avoid them by continuing to use only one carrier.

C. *Emergency services*

Section II (BOC Requirements) Para. D(2) prevents the BOC from manufacture or provision of telecommunications products or customer premises equipment except for provision of customer premises equipment for emergency services. Emergency services are not defined. Would the BOC need only to maintain a supply of telephones for use in case of a disaster or would it be required to provide premises equipment on an ongoing basis to public safety agencies? In either event, the BOC must maintain a stock of equipment and an associated installation and maintenance expertise on this equipment.

There appears to be little reason to require the BOC to provide customer equipment for emergency use except to insure its availability at the time of a disaster. Limiting the definition of emergency services provided by a BOC to that of a disaster condition would limit the costs to the BOC of this function.

It is questionable whether, under the Decree, the BOC would be allowed to provide all of the Enhanced 911 (E911) service features currently contemplated as a BOC offering. This service normally requires a separate processor, in a processor controlled central office (ESS or digital), to perform the Automatic Location Identification (ALI) function and to provide the office processor telephone number transfer information, so that automatic routing from and to an emergency report center is possible. If the Automatic Location Identification feature is defined as an information service, then the BOC may not be able to provide Automatic Location Information under the Decree's restrictions. However, if the ALI function is considered to be a directory service, the BOC's would be allowed to provide the feature. The Decree should be clarified to allow the BOC to provide ALI.

D. Private line services

The Decree is silent on private line services. If the BOC's are prohibited from providing this service it would result in the duplication of many existing local facilities by others.

We believe the BOC's should provide private line services between points within the BOC's exchange areas. In addition, the exchange facilities for an interexchange private line should be provided by the BOC on a non-discriminatory basis and the interexchange portion of the circuit should be provided by AT&T or other carriers.

E. Coin telephone service

The Decree is also silent regarding the provision of coin telephone service. We feel that public coin service should be provided by the BOC. and that this should include provision, installation, and maintenace of the coin telephone instrument, as well as necessary central office facilities.

The situation regarding semi-public coin telephone service is less clear. Semi-public service is a subscriber requested service carrying a monthly charge. The coin telephone is installed on private property, at the request of the property owner, to meet a specific need experienced by the owner. In many instances, the owner requests the coin line be equipped with an answer-only (no dial) extension. If this service is to be provided by the BOC, it appears to conflict with the prohibition against providing customer premises equipment. If provided by others, there are problems with coin box collections. If the service is eliminated, a customer need is not met.

The Language of the Decree should be modified to permit the BOC to provide total coin telephone service. Our previous argument to allow BOC ownership of operator services certainly applies here.

VI. CONCLUSIONS

We believe we have identified a substantial number of important conerns, both financial and technical/operational, which relate to whether the divestiture, proposed in the Decree, is in the public interest. There are probably many more to be found. Time was short for this analysis.

If divestiture is ultimately found to be in the public interest, and we are not convinced that it is, many of the problems outlined in this analysis should be dealt with in the Decree itself. There also appear to be several areas where Federal legislation is needed to establish or preserve important public interest policies such as, maintenance of universal service at affordable rates, fair asset valuation procedures and regulation of the dominant interexchange carrier, AT&T, as long as the public interest requires.

Immediate FCC or Joint Board actions will be necessary to smooth the transitional effects of the proposed elimination of the separations process and to properly classify inside wiring on customers' premises as a competitive market, subject to deregulation on terms similar to those applicable to customer premises equipment.

ATTACHMENT A.—*Loss of the interstate revenue support: Allocation of non-traffic sensitive costs including CPE*

Company:	*Monthly increase*
1. Nevada Bell	$21.38
2. Continental Telephone Co	23.59
3. Central Telephone Co	13.01
4. Lincoln County Telephone System	20.68
5. Moapa Valley Telephone Co	8.73
6. Rio Virgin Telephone Co	20.52
7. Churchill County Telephone and Telegraph System	16.01
8. Nevada Telephone—Telegraph Co	26.06

[The following information was subsequently received for the record:]

PUBLIC SERVICE COMMISSION,
STATE OF NEVADA,
Carson City, Nev., April 2, 1982.

Senator HOWARD W. CANNON,
U.S. Senate, Committee on Commerce, Science, and Transportation, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR CANNON: Thank you for having provided the Public Service Commission with the opportunity to express its views at the recent hearing the Reno.

Enclosed are supplemental comments for the record prepared in response to questions raised during the course of the hearing. The comments are directed toward your expressed concern about the weak financial position of Pacific Telephone and how that would affect rates for Nevada telephone users, and the feasibility of affiliating Nevada Bell with a regional group of BOCs other than Pacific Telephone. Also, I have attempted to clarify the issues of asset valuation and the potential impact on Moapa Valley Telephone Company.

Hopefully these additional comments will help to resolve some of the issues raised by the discussion at the Reno hearing. If the Commission can be of any further assistance please do not hesitate to contact us.

Sincerely,

JOHN M. HOLMES,
Director of Regulatory Operations.

Enclosures.

SUPPLEMENTAL COMMENTS OF PUBLIC SERVICE COMMISSION OF NEVADA

During the recent hearing in Reno, the question arose regarding the impact of the proposal by American Telephone & Telegraph (AT&T) which provides for creating seven regional operating companies with Nevada Bell being associated with Pacific Telephone and Telegraph (PT&T). As noted in the testimony of the Public Service Commission of Nevada (Commission) at the hearing this may not be a favorable corporate structure for Nevada Bell.

It was this concern which gave rise to the question regarding the feasibility of Nevada Bell being affiliated with another regional group of BOCs. At the outset it should be noted that the Commission would welcome a study of a different regional affiliation for Nevada Bell. In our opinion the most likely group is the one proposed to include the present BOCs of Pacific Northwest Bell, Northwestern Bell and Mountain Bell.

A primary concern of the Commission with linking Nevada Bell with PT&T is in the determination of cost of capital. Presently, Nevada Bell has no public stock of its own. Hence, the Commission cannot ascertain an appropriate market value or cost of equity. In the past the Commission has imputed AT&T's capital structure to Nevada Bell for determining an appropriate cost of capital and revenue requirement. (This was the approach used by the Commission in the recent Nevada Bell case, Docket No. 81-034). If Nevada Bell were to be grouped, as proposed, with PT&T the Commission would no longer be able to impute the capital structure of AT&T to Nevada Bell. Under the proposed structure the Commission would be limited to imputing PT&T's capital structure. It is this organizational change which poses the problem of increased costs for Nevada Bell. PT&T's bond rating is "A−" and "A" as opposed to AT&T's "AAA" rating. This differental in bond ratings clearly indicates the increased costs which will be imposed on Nevada Bell's capital structure to the detriment of Nevada Bell's ratepayers.

A cause for this disparity in bond ratings may be the various treatment afforded BOCs by the many regulatory jurisdictions. PT&T is subject to the jurisdiction of the California Public Utilities Commission. The California Commission in the past has not been as favorable to PT&T when engaging in ratemaking. This has a significant impact on PT&T's bond rating. AT&T, on the other hand, can avoid the implications of unfavorable treatment by one jurisdiction when the consideration of other jurisdictions blend together to form an average or consensus regulatory approach.

In addition to the cost increases attributable to capital structure treatment, the study of placing Nevada Bell with a group of BOCs other than PT&T should consider factors such as political, social and economic attitudes of the jurisdictions charged with regulating the BOCs. Nevada traditionally aligns itself in terms of political and social attitudes more closely with the other intermountain states which include the aforementioned BOCs. Whereas, Nevada's relationship with California has not been as compatible.

Furthermore, the Commission finds it necessary to offer a clarification on the issue of asset valuation and the division of assets between AT&T and the BOCs. The revenue stream associated with particular assets given to the BOCs is a significant issue. The BOCs are to engage in "natural monopoly service actually regulated by tariff." Therefore, the currently filed tariff is the revenue that will be derived from that asset. As presented in our original comments, the BOCs are getting stuck with many of the under-priced assets such as intraexchange private line services, whereas, AT&T gets the lucrative long-haul toll service.

Finally, the Commission offers the following clarification of the question on why Moapa Valley Telephone Company (Moapa Valley) is not impacted so greatly as others in the state with the proposed changes. This company has a smaller investment in toll plant than do the other companies shown in the attachment. (See Attachment "A" to the Comments of Public Service Commission) Centel owns the microwave facility that handles the toll traffic out of Moapa Valley into the Las Vegas toll swtich. Therefore, changes in settlements impacts Centel's greater investment and conversely, Moapa's low investment is not affected to the same degree. The total overall loss from the contribution from interstate settlements is about the same, but in this case the small company is somewhat isolated by its minority ownership in toll facilities. Accordingly, Centel is keepiing a larger portion of the revenues generated. Moapa Valley was purposely chosen as an example of how the settlement process impacts various companies differently within the state. It also has a wide range of effect when viewed nationally. (See attached Appendix "A".)

APPENDIX A—EFFECT OF PER-LINE CHANGE IN INTERNATIONAL SEPARATIONS ON INDIVIDUAL LINE RESIDENCE RATE IN LARGEST BELL EXCHANGE IN EACH STATE [1]

[Assumes elimination of weighted minutes of use (SPF factor) under Ozark plan with substitution of SLU factor and elimination of terminal equipment and station connections from the allocation of subscriber plant costs to interstate operations Bell Co. Exchanges, year 1980 Basis]

State and city	Monthly individual line residence rate, [2] July 1, 1980	Monthly effect of separation change, [3] year 1980	Rate adjusted for separation change	Percent increase
Alabama, Birmingham	$13.50	$4.92	$18.42	36.4
Arizona, Phoenix	9.50	9.50	19.00	100.0
Arkansas, Little Rock	9.95	5.92	15.87	59.5
California, Los Angeles	6.00	5.25	11.25	87.5
Colorado, Denver	8.00	9.08	17.08	113.5
Connecticut, Hartford	8.77	6.00	14.77	68.4
Delaware, Wilmington	7.95	6.08	14.03	76.5
District of Columbia, Washington	9.65	8.08	17.73	83.7
Florida, Miami	12.30	9.83	22.13	79.9
Georgia, Atlanta	11.85	6.66	18.51	56.2
Idaho, Boise	7.00	7.25	14.25	103.6
Illinois, Chicago	[4] 5.55	4.83	10.38	87.0
Indiana, Indianapolis	11.25	4.08	15.33	36.3
Iowa, Des Moines	9.10	5.08	14.18	55.8
Kansas, Kansas City	7.35	5.58	12.93	75.9
Kentucky, Louisville	11.44	4.25	15.69	37.2
Louisiana, New Orleans	11.10	5.00	16.10	45.0
Maine, Portland	10.25	5.17	15.42	50.4
Maryland, Baltimore	9.42	3.83	13.25	40.7
Massachusetts, Boston	9.70	4.92	14.62	50.7
Michigan, Detroit	8.75	3.08	11.83	35.2
Minnesota, Minneapolis	9.50	5.25	14.75	55.2
Mississippi, Jackson	14.75	6.08	20.83	41.2
Missouri, St. Louis	8.50	5.00	13.50	58.8
Montana, Billings	5.75	8.00	13.75	139.1
Nebraska, Omaha	9.45	7.83	17.28	82.9
Nevada, Reno	8.35	18.92	27.27	226.6
New Hampshire, Manchester	10.90	8.00	18.90	73.4
New Jersey, Newark	7.65	5.42	13.07	70.8
New Mexico, Albuquerque	7.85	7.33	15.18	93.4
New York, New York City	[5] 6.04	5.66	11.70	93.7
North Carolina, Charlotte	8.55	4.75	13.30	55.6
North Dakota, Fargo	9.65	7.33	16.98	75.9
Ohio, Cleveland	11.95	3.42	15.37	28.6
Oklahoma, Oklahoma City	6.20	6.17	12.37	99.5

APPENDIX A—EFFECT OF PER-LINE CHANGE IN INTERNATIONAL SEPARATIONS ON INDIVIDUAL LINE RESIDENCE RATE IN LARGEST BELL EXCHANGE IN EACH STATE [1]—Continued

[Assumes elimination of weighted minutes of use (SPF factor) under Ozark plan with substitution of SLU factor and elimination of terminal equipment and station connections from the allocation of subscriber plant costs to interstate operations Bell Co. Exchanges, year 1980 Basis]

State and city	Monthly individual line residence rate,[2] July 1, 1980	Monthly effect of separation change,[3] year 1980	Rate adjusted for separation change	Percent increase
Oregon, Portland	$8.05	$6.58	$14.63	81.7
Pennsylvania, Philadelphia	6.65	3.17	9.82	47.7
Rhode Island, Providence	13.00	4.75	17.75	36.5
South Carolina, Columbia	9.80	4.75	14.55	48.5
South Dakota, Sioux Falls	7.75	7.33	15.08	94.6
Tennessee, Memphis	10.80	4.42	15.22	40.9
Texas, Houston	8.15	5.33	13.48	65.4
Utah, Salt Lake City	9.17	5.42	14.59	59.1
Vermont, Burlington	10.10	9.00	19.10	89.1
Virginia, Richmond	9.55	5.50	15.05	57.6
Washington, Seattle	8.25	5.58	13.83	67.6
West Virginia, Charleston	14.83	4.33	19.16	29.2
Wisconsin, Milwaukee	9.50	3.42	12.92	36.0
Wyoming, Casper	7.79	16.42	24.21	210.8

[1] In practice, the revenue requirement resulting from a shift from interstate would probably be spread in proportion to the basic rate. Business rates would have a higher increase; rates in smaller exchanges would have a lesser increase. Because of the variation above and below the large city residential rate it is probable that these rates would pick up close to the average increase per line.

[2] NARUC exchange service telephone rates in effect June 30, 1980.

[3] A.T. & T. reply to information request No. 2 to Joint Board in FCC CC Docket No. 80-286, average interstate revenue requirement removed from interstate per main station.

[4] Measured rate, includes 80 message units.

[5] Measured rate, includes message allowance of $4.00 usage.

Senator **CANNON**. Thank you very much, Mr. Holmes.

We will next hear from Jon Wellinghoff, consumer advocate, attorney general's office, State of Nevada.

STATEMENT OF JON WELLINGHOFF, OFFICE OF CONSUMER ADVOCATE, STATE OF NEVADA

Mr. **WELLINGHOFF**. Thank you, Senator.

On behalf of my office and the attorney general of the State of Nevada, I sincerely appreciate the opportunity to appear before the committee at this hearing and present our views on the recent settlement reached between the Justice Department and A.T. & T. and the potential impact of that settlement on local rates and services for Nevada Bell's customers.

I also wish to thank Senator Cannon for proposing these hearings and giving Nevadans the opportunity to provide input to the Congress of the United States regarding these most significant developments in the area of telecommunications.

The statements and views offered by our office today will propose very few, if any, solutions to the myriad of problems which potentially could result in the court settlement of the A.T. & T. matter. We hope, instead, however, to pose a number of vital questions which consumers share over the resolution and implementation of the settlement process between the Justice Department and A.T. & T.

The primary theory underlying the history of telecommunications service in this country has been the provision of universal service to all potential customers in the telephone company's certificated service area. This goal has largely been achieved in Nevada, in our view. It is one that should be maintained. Thus, the maintenance of basic phone service to both residential and business customers in Nevada at an economically affordable level is the primary goal of our office.

In review of the settlement agreement reached between the Justice Department and A.T. & T., it is our opinion that that agreement may need focus and direction from Congress via legislation to insure that the economically affordable and technically adequate service that should be maintained for Nevada Bell customers is in fact maintained after the settlement has been fully implemented.

Such congressional direction must reinforce the public interest in providing basic affordable telephone services, and must second insure that States are afforded adequate flexibility to regulate those communication services in a manner which insures that the basic service goals outlined above are continued.

The key to preserving basic telephone service access universally in Nevada Bell's service area is insuring that service is provided at an affordable rate. The primary question consumers are asking of the A.T. & T. settlement is, what effect will the settlement have on rates? It seems from the press reports and news releases related to the settlement that the public is being conditioned for substantial rate increases. A doubling or even tripling of current basic telephone service rates seems a standard response when sources close to the settlement are asked for an opinion regarding the potential rate impact.

We believe strongly that there should be no preconceived notions as to the impact of the settlement on an individual consumer's telephone rate. Each State commission, including the Nevada PSC, must determine on a cost of service basis what a just and reasonable rate will be for Nevada Bell's customers after the settlement process has been fully implemented.

Unfortunately, Nevada Bell, as early as January of 1981, in filing its most recently decided case before the Nevada Public Service Commission, used as one of the reasons for the need for increased rates the introduction of competition into the telephone industry. Again, we assert that both the introduction of competition and the furtherance of that competition through the implementation of the A.T. & T. court settlement do not necessarily mean that rates must increase substantially.

That self-fulfilling prophecy will only come about if Congress and the State regulatory commissions fail to insure that the implementation of the A.T. & T. settlement provides for the continued economic integrity of the Bell operating companies, including Pacific Tel and Tel and Nevada Bell. The maintenance of that economic integrity is dependent upon the answer to a number of specific questions which I have discussed in detail in my full prepared statement. In the interest of brevity, I will only enumerate those questions here.

They are, one, will jurisdiction for local telephone service and rates be maintained and strengthened at the State level? Two, will Nevada Bell remain a subsidiary of Pacific Tel and Tel? Three, how will Nevada Bell's public service obligation be defined in the future? Four, to what extent will Nevada Bell be able to continue interexchange services? Five, will Nevada Bell be given yellow page operations? Six, what will be the effect of a change in interstate separations? And seven, how will the proposed transfer of assets affect the financial health of Nevada Bell?

Even though technological advancement in telecommunications and increasing competition in the equipment field has allowed this country to make significant strides in communications and data transmission, we should not let these advances undermine the current status quo. Consumers have a right to affordable basic telephone service. The Congress must insure that the proposed Justice-A.T. & T. antitrust settlement in no way abrogates that right.

I hope that careful consideration of the questions I have posed will assist you in furtherance of that duty.

In conclusion, I wish to again thank and congratulate Senator Cannon for the concern he has expressed for Nevada Bell's telephone subscribers by holding these hearings, and on behalf of those subscriber who are dependent upon affordable local exchange service, I wish to offer any assistance our office may provide in maintaining and improving such service here in northern Nevada.

Thank you, Senator.

[The statement follows:]

Statement of Jon Wellinghoff, Consumer Advocate, State of Nevada

Senator Cannon and Members of the Committee: On behalf of my office and the Attorney General of the State of Nevada, I sincerely appreciate the opportunity to appear before the Committee at this hearing and present our views on the recent settlement reached between the Justice Department and AT&T and the potential impact of that settlement on local rates and services for Nevada Bell's customers. I also wish to thank Senator Cannon for proposing these hearings and giving Nevadans an opportunity to provide input to the Congress of the United States regarding these most significant developments in the area of tele-communications.

As Consumer Advocate for the State of Nevada, under the auspices of the State Attorney General, Richard Bryan, our office is charged by statute with representing the interests of ratepayers of all public utilities under the jurisdiction of the Nevada Public Service Commission. The legislation which created our ofice (AB 473) authorizes our appearance not only before the Nevada PSC but also before other federal and state entities where the utility consumers' interests may require representation. The statutory authorization of our office does restrict us from intervention in communication matters where the utility certifies under oath that the issue under consideration is subject to competition. It has been our position, however, that any area where a matter subject to competition may in some way impact the noncompetitive or monopoly market, our office may provide representation for those monopoly market consumers. Accordingly, we believe that our appearance here today to represent the consumers of Nevada Bell relative to the settlement reached between the Justice Department and AT&T and to indicate to the Senate Commerce Committee our concerns over that settlement, is an appropriate function of the Consumer Advocate's Office.

The statements and views offered by our office today, will propose very few, if any, solutions to the myriad of problems which potentially could result from the court settlement of the AT&T matter. We hope instead, however, to pose a number of vital questions which consumers share over the resolution and implementation of the settlement process between the Justice Department and AT&T.

The primary theory underlying the history of tele-communication service in this country has been the provision of "Universal Service" to all potential customers in a telephone company's certificated service area. This goal has largely been achieved in Nevada and in our view, it is one that should be maintained. Thus the maintenance of basic phone service to both residential and business customers in Northern Nevada at an economically affordable level is the primary goal of our office. In review of the settlement agreement reached between the Justice Department and AT&T, it is our opinion that that agreement may need focus and direction from Congress via legislation to insure that the economically affordable and technically adequate service that should be maintained for Nevada Bell's customers is, in fact, maintained after the settlement has been fully implemented. Such Congressional direction must reinforce the public interest in providing basic affordable telephone services and must secondly insure that states are afforded adequate flexibility to regulate those communication services in a manner which insures that the basic service goals outlined above, are continued.

The key to preserving basic telephone service access universally in Nevada Bell's service area is insuring that service is provided at an affordable rate. The primary question consumers are asking of the AT&T settlement is "What effect will the settlement have on rates". It seems from all the press reports and news releases related to the settlement that the public is being conditioned for substantial rate increases. A doubling or even tripling of current basic telephone service rates seems a standard response when sources close to the settlement are asked for an opinion regarding the potential rate impact. We believe strongly that there should be no preconceived notions as to the impact of the settlement on an individual consumer's telephone rate. Each state commission, including the Nevada PSC, must determine on a cost of service basis what a just and reasonable rate will be for Nevada Bell's customers after the settlement process has been fully implemented. Unfortunately, Nevada Bell as early as January of 1981 in filing its most recently decided case before the Nevada Public Service Commission (Docket No. 81-034) used as one of the reasons for the need for increased rates the introduction of competition into the telephone industry. Again we assert that both the introduction of competition and the furtherance of that competition through the implementation of the AT&T court settlement do not necessarily mean rates must increase substantially. That self-fulfilling prophecy will only come about if the Congress and the state regulatory commissions fail to insure that the implementation of the AT&T settlement provides for the continued economic integrity of the Bell operating companies including Pacific Tel & Tel and Nevada Bell. The maintenance of that economic integrity is dependent upon the answer to a number of specific questions which I would like to pose and discuss below.

WILL JURISDICTION FOR LOCAL TELEPHONE SERVICE AND RATES BE MAINTAINED AND STRENGTHENED AT THE STATE LEVEL?

The 1934 Communications Act unambiguously left jurisdiction for state telephone regulation, both local exchange and intrastate toll, for the states. Because of the myriad of federal activities, however, such as the AT&T settlement and the FCC hearings on such issues as expensing inside equipment, consumers and state regulators have assumed that the FCC has the authority to decide the nature of state telephone service. If we are to maintain affordable local telephone service, there must be sufficient jurisdiction and exercise of authority on the state level to provide for the economic health of local telephone companies such as Nevada Bell. It is our opinion that state regulatory authority should be maintained and enhanced. This does not mean, however, that there should be no policy direction to those state regulatory bodies from the federal level. Such direction is not only desirable but necessary to maintain reasonably priced local service.

WILL NEVADA BELL REMAIN AS A SUBSIDIARY OF PACIFIC TELEPHONE & TELEGRAPH?

The proposed AT&T settlement is silent on this specific issue and in fact defines Bell operating companies (BOC) as not only those specific BOC's listed in Appendix A to the modification of final judgment, but also "any entity directly or indirectly owned or controlled by a BOC or affiliated through substantial common ownership." (Modification of Final Judgment, *U.S. v. Western Electric Company, Inc. and American Telephone & Telegraph*, Civil Action No. 17-49, p. 6) Thus it appears that Nevada Bell could become a separate operating entity under the proposed settlement. The primary question which must be answered, however, is whether Nevada Bell operating as an entity separate from Pacific Tel & Tel Co. could provide the least cost, adequate service to its consumers in the future. There may be numerous advantages and disadvantages to Nevada Bell becoming a separate entity from Pacific Tel & Tel. These should be fully explored and the Nevada Public Service Commission as well as the California PUC should be given complete flexibility to investigate and finally decide the issue. The resolution of the issue will no doubt hinge on a determination of each company's public service obligation to its individual ratepayers.

HOW WILL NEVADA BELL'S PUBLIC SERVICE OBLIGATION BE DEFINED IN THE FUTURE?

Nevada Bell is currently regulated at the state level under state law to provide "adequate service at reasonable rates." This basic law establishes the premise that a telephone company has an obligation to provide service. A central problem vexing telephone regulation for the future is the meaning of that term. Does it include enhanced services, high technology service, or just basic voice communication. The problem we, as State Consumer Advocate, have with the terms of the debate by the telephone industry, specifically AT&T, is that it discusses the issues in pure financial or costing terms and ignores the engineering. Any telephone company is first and foremost an engineering operation consisting of wires, switches, transmitters, requirements greater for "enhanced" services and computer communication. Because *all* telephone use starts with the local loop, the more complex engineering services are dictating the engineering. As a result, as new technology is developed and competitive markets arise, it creates a "need" to retool the basic engineering at great expense (which is going on to the tune of $18 billion plus a year on the Bell system, an increase in capitalization of over 13 percent a year). That expense requires money which, as a marketing tactic, the Bell system seeks out of the local service market—not out of the markets requiring the new enginering. Even though most local voice telephone users are not demanding the enhanced service, the Bell system continues to "upgrade" the public service provided for basic voice communication. While the FCC focus has been on the effect of sophisticated communication technology, states must and do deal with basic telephone service. The definition of "adequate service at reasonable rates" and the engineering necessary to meet that obligation for basic voice service must continue to be left to the states. In addition, understanding the engineering nature of the business allows one to better allocate costs, price services, and to judge the relationship between dividing up the corporate and financial structure of AT&T vs. dividing up its marketing and engineering.

TO WHAT EXTENT WILL NEVADA BELL BE ABLE TO CONTINUE INTEREXCHANGE SERVICES?

It is my understanding that the AT&T settlement proposal would strip Nevada Bell of the authority and assets necessary to provide interexchange (toll) services. The apparent intent of the Department of Justice in proposing to settle its case with AT&T is to promote competition and efficiency in the nation's telecommunications markets. The effect of the proposed settlement will be to strengthen AT&T's monopoly position in the intercity market, thus stifling competition. In addition, preventing the operating companies from provisions of any interexchange services will relegate them to a stagnant role in the market place, possibly causing an increase in their cost of capital, and thus applying upward pressure on local rates.

Thus, it seems appropriate that ownership of the intercity facilities of Nevada Bell should remain with the operating company. This should include, at minimum, the associated facilities necessary to perform interexchange communications and information services.

Since the intent of the proposed settlement is to promote competition, it must then follow, that a completely independent, divested operating company also be allowed to provide interexchange telecommunications and information services.

WILL NEVADA BELL BE GIVEN YELLOW PAGE OPERATIONS?

A seemingly fundamental precept upon which the AT&T settlement is based, is the bifurcation of exchange and interexchange service. In the instance of Yellow Pages, there is a patent inconsistency in the construction of the settlement agreement, for this is an aspect of local telephone service. These operations and the resulting revenues should not be conscripted from the local companies; to do otherwise would result in an obvious windfall to AT&T and do little, if anything, to enhance a competitive environment in the telecommunications industry. AT&T has sought legal recourse in several instances where regulators have included yellow page revenues in setting rates. I believe this Committee should consider developing a clear policy with regard to this issue and that the states must be allowed to consider yellow page revenues in setting rates to thereby further the goal of universal service at reasonable costs to consumers. Furthermore, if Nevada Bell remains a subsidiary of Pacific Tel & Tel, the Nevada PSC should maintain the authority to ensure that the benefit of Nevada's yellow page operations remain with Nevada Bell.

WHAT WILL BE THE EFFECT OF A CHANGE IN INTERSTATE SEPARATIONS?

One major effect of the AT&T settlement will be to take away from the BOC's, such as Nevada Bell, the highly lucrative revenues associated with the separations and settlements process. This could have a substantial impact on Nevada Bell's ratepayers. In fact, one estimate I have seen which was a chart prepared by AT&T indicated that the monthly effect of separations change on Nevada Bell customers individual line residence rate would be an increase of $18.92 or a 226 percent increase. This would be the highest increase in the country as a result of the separations change.

The prevailing alternative proposal to the separations and settlements process after the AT&T divestiture would be the establishment of a system of access charges to be provided to the local operating companies. Current proposed Congressional legislation provides for this scheme. The importance of an access charge system in ensuring that the separations and settlements phase out does not result in exhorbitant consumer increases warrants some specific comment.

While I endorse the concept of an access charge, I would make two suggestions. First, the states should be allowed to set the access charges for calls within each particular state instead of delegating this function to the FCC. This is consistent with the 1934 Communication Act. State regulators and the parties who regularly litigate issues of cost and service are most familiar with the particularly conditions which exist in the rate structures of each state. Utility rates of capital intensive companies, such as telephone utilities, are traditionally set in trial-type adversarial proceedings which allow all evidence considered to be subject to forms of discovery, examination and cross-examination found in most legal proceedings. By ceding to the FCC the mammoth task of setting access charges for every exchange in the country, litigation which normally would be concentrated at the state level would shift to the FCC. It is difficult to envision how such a result would improve the efficiency of governmental regulation and, in fact, such a transfer of authority to the Federal Government runs counter to the clear trend of increasing local control and diminishing federal control. I urge you instead, as part of your efforts to enunciate a telecommunications policy for the 1980's and beyond, to define to the minimum degree necessary the goals or formulate by which state regulators should be guided but allow responsible state officials to set their own access changes pursuant thereto and consistent with local exigencies. This formula should be based on the fully allocated costs.

Another comment I would make with regard to the subject of access charges concerns the apparent lack of any restraints upon AT&T tp bypass the local network by providing local service to major customers as part of the interexchange service and, thus, to frustrate the access charges system designed to assure universal service at reasonable rates. AT&T has agreed in the antitrust settlement to configure the operating companies so as to inhibit their ability to compete with it in the provision of interexchange services. If, as seems probable, the access charge system becomes a reality, AT&T would surely have the economic incentive to deploy available technology to escape the access charge obligation. Both incentive and opportunity should be removed by the imposition of legal constraints which assure that sources of revenue valuable to the economic viability of the local network not be siphoned off. AT&T should also be prevented from competing in any fashion with the local exchange companies for the exchange business which they may well become vitally dependent upon.

HOW WILL THE PROPOSED TRANSFERS OF ASSETS EFFECT THE FINANCIAL HEALTH OF NEVADA BELL?

The proposed divestiture raises several questions as to the effect which the method of transfer of assets, and valuation thereof, will have upon the financial health of Nevada Bell. A broad area of concern is the superior position which AT&T will enjoy in determining the assets and capital structure to be allocated to the operating companies. Although the Department of Justice, in its "Competitive Impact Statement," asserts that it "will ensure . . . the BOC's are given all assets necessary" to remain viable, I think concern should be expressed in this area. First, it is the operating companies, not the Department of Justice, nor even the regulators, that have the better access to data required to identify the assets and sources of financing necessary to perform efficiently. Moreover, AT&T will have the obvious incentive, and indeed the ability, to assign the higher cost portions of its consolidated capital structure (such as recently issued debt) to the BOC's, while keeping the cheaper and older sources of capital for its remaining, unregulated operations.

No guarantee of the ability of the BOC's to negotiate at an arm's length basis for the valuation and transfer of sufficient assets exists under the proposed antitrust settlement agreement. It may be appropriate that the structure of a divestiture be modified to more nearly equalize the position of the BOC's as they negotiate the identity and valuation of the assets to be transferred. This problem is well articulated in the proposal made by the Attorney General of New Mexico to Judge Greene that, in effect, a guardian *ad litem* be appointed to protect the interests of the BOC's. A further problem arises with respect to Nevada Bell, and its ability or need to negotiate with AT&T as an entity separate and apart from Pacific Tel & Tel. The question of primary importance is whether Nevada Bell's and Pacific Tel & Tel's interests are completely compatible in this area.

If we assume that the settlement agreement will not be changed to facilitate a more meaningful negotiating posture for Pacific Tel & Tel and Nevada Bell, there remain several areas which the Committee should consider.

First is the treatment of assets which are the subject of affiliated transactions among the Bell System Companies. As you know, the License Contract which currently exists between the operating companies and AT&T will be terminated by operation of the antitrust settlement agreement. While payments are made by Nevada Bell under the contract for certain research and for the use of patents undertaken and developed by Bell Telephone Laboratories, there is no recognition in the current antitrust settlement agreement that Nevada Bell's basic exchange ratepayers have over the years paid for some proportion of the research which has led to the development of those patents by Bell Labs. Thus, even though the settlement agreement required Bell Labs to furnish "research, development . . . and other support services" until 1987, it may be necessary to enact legislation which recognizes the ratepayer as a primary source of capital through which have been developed the existing patents held by AT&T as well as future patents which may be enrolled as a result of funding pursuant to the License Contract. Continuing payments by AT&T to the divested companies is one method to recognize the past ratepayer financings.

In addition to termination of the License Contract, the settlement agreement abrogates the existing Standard Supply Contract between Western Electric Company and the BOC's. As with Bell Labs, Western Electric Company is required for a period of time under the proposed agreement to provide manufacturing and other services to the BOC's. This requirement stems from the fact that, historically, the BOC's have relied upon Western Electric for their equipment and have accordingly standardized their systems almost exclusively to utilize Western's equipment, particularly in the area of local dial switching.

Termination of the contract will not, standing alone, lessen the degree to which Western enjoys a captive market for a large share of its product line. This dependence upon Western's equipment, coupled with the fact that Western has historically enjoyed high returns on sales of its local dial switching, creates concern that the BOC's may need protection from excessive charges imposed by Western until they are weaned from dependence on its products. In order to address this problem, it may be appropate that Congress require full disclosure by Western of its earnings on sales to the BOC's, by classes of plant and product line, until such time as the BOC's are no longer dependent on Western Electric equipment.

A final but significant point to consider concerns the appropriate disposition of deferred tax reserves and investment tax credits upon divestiture of Pacific Tel & Tel and Nevada Bell from AT&T. Through a process of tax "normalization," a substantial amount of taxes associated with telephone utility equipment have been accumulated and paid for by the ratepayers over time. The settlement agreement is silent on the subject of the appropriate disposition of these taxes. I am hopeful that the Congress will prescribe a treatment of these tax reserves and credits to assure that they are not allocated to unregulated operations and to insure that customer/ratepayers are not deprived of the benefit of these monies previously paid. This is especially important in view of the recently enacted Economic Recovery Tax Act (ERTA) which establishes an accelerated cost recovery system (ACRS) for expedited depreciation of certain utility property. The fact that the proposed divestiture will occur contemporaneously with the period when the faster write-offs are being allowed, demands close scrutiny to assure that the BOC's and ratepayers are not stripped of tax benefits which are rightfully theirs. I urge you to act to prevent such a result.

CONCLUSION

Even though technological advancement in telecommunications and increasing competition in the equipment field has allowed this country to make significant strides in communications and data transmission we should not let these advances undermine the current status quo. Consumers have a right to affordable basic telephone service. The Congress must ensure that the proposed Justice, AT&T antitrust settlement in no way abrogates that right. I hope that careful consideration of the questions I have posed will assist you in the furtherance of that duty.

In conclusion, I wish to again thank and congratulate Senator Cannon for the concern he has expressed for Nevada Bell's telephone subscribers by holding these hearings and on behalf of those subscribers who are dependent on affordable local exchange service, I wish to offer any assistance our office may provide in maintaining and improving such service here in Northern Nevada.

Senator CANNON. Thank you very much, Jon.

That concludes the witness list, and we will now take a break until 11:05 and let you all stretch before we start the questions.

[Whereupon, a brief recess was taken.]

Senator CANNON. All right. If we can resume our seats here as quickly as possible, we will get under way again.

All right, the hearings will resume.

I would like to begin the questioning with a number of issues that were raised in the testimony of Mr. Holmes. Most of you have commented either directly or indirectly on many of these issues in your formal statements, but I think some additional elaboration might be useful.

Undoubtedly the most provocative portion of the testimony concerns the effect of the proposed settlement on local telephone rates. Mr. Holmes suggests that local rates may go up by as much as 200 percent. He also includes an attachment to his testimony that shows potentially enormous rate increases by the various different Nevada telephone companies. I would like to get the reaction of the various telephone carriers here today to these predictions.

First, let me ask John Christian. In that context, I would like to explore your comments in a little more detail. As I understand your statement, the severe pressures on local rates are a result of decisions that have already been made by the FCC. Is that correct?

Mr. CHRISTIAN. To some extent, yes, Senator.

Senator CANNON. Well, now, if so, do you think that the proposed settlement between the Justice Department and A.T. & T. might actually be used as an opportunity to correct some of these problems by assuring adequate revenues through the access charge mechanism?

Mr. CHRISTIAN. The access charge mechanism, of course, is the key to it all, and if they are compensatory, well, the situation will be rectified, but at this point in time we do not know which way it is going to go.

Senator CANNON. I am sure that all of you recognize that if rural America or rural Nevada in particular is going to have to have price increases as a result of this settlement along the lines that have been indicated here, that that is not acceptable. So let me see if we have any volunteers out here who would like to take a shot now at this particular point.

Mr. GUINN. Well, Senator Cannon, I would comment——

Senator CANNON. All right, Mr. Guinn.

Mr. GUINN. First of all, I think you have done an excellent job in selecting the people to participate on your panel. Having followed fairly closely the debate across the Nation, as I know you have in your hearings, it seems to me you have most of the issues on the table. This is one of the issues, the cost of exchange service. I would like to first of all characterize that it does not come about because of the consent decree—as you pointed out, the consent decree might provide some solutions—but the loss of subsidy to local service and the loss of settlement revenues to the independents which John Christian spoke of is brought about by the changing public policy that has introduced competition which has driven prices to economic cost—which in turn has changed the rate structure that has served this country so well over the years. So, it is a changing public policy that has created the problem. The consent decree is one solution to that problem.

It is interesting to me that the one party rate in John Christian's company is significantly lower than Bell of Nevada's one party rate in Reno. So is the one party business rate. Since I assume that the costs are higher to provide service there, certainly they are higher in our rural communities, it must mean that a subsidy has been provided in those companies. It is going to create some changes as we go forward and lose this subsidy that has been there before—but this has been caused by competition, not the consent decree.

Now, the question is, How can it be handled? There are two ways it could be handled. One of them is through a good working relationship between the independents and the Bell companies and the commissions who regulate us to set these rates in an appropriate way so that the access charge provides a contribution above cost to help replace this lost subsidy, but is not so high that it invites other common carriers like our friends from Southern Pacific—makes it economically attractive for them to bypass our local facilities.

That bypass is going on in our company and in the Nation today. So, even though BOC's, the local exchange companies after divestiture, are described as a natural monopoly, we still have competition today and with technology improving we are going to have more in the future. The way we hold down the bypass is to make it not economically attractive. That flies in direct opposition to a contribution above costs on access charges. That has to be delicately handled.

The other thing is something that we have pursued diligently in both California and Nevada, because we have a lot of rural customers in both States. That is to try to get technology that is more cost effective. We have recently, last November, I believe, installed a remote switching unit in Churchill Butte, which I understand is about 35 miles east of Carson City. That is a very small switching machine that is a slave machine off the host No. 1 ESS electronic switching machine in Carson City. We put that machine in at low cost to a very small number of customers. I think the capacity is about 500 lines. So, we gave them low-cost service and sophisticated service, the same kind of service that is available in Carson City. In that matter we are aggressively pursuing it. I think Mr. VanAllen could probably tell you how many of those he has planned.

So, one way is to aggressively seek and pursue technology that helps to bring modern telephone service to the rural communities in an affordable way. The other one is to carefully manage this access charge. The third one, I believe, and it was mentioned by a couple of us here this morning, is to aggressively pursue in the future usage-sensitive prices so that the people who create the costs pay the costs. That will help to hold down all local exchange rates, including rural rates.

Senator Cannon. Yes.

Mr. Holmes. I would like to respond here to a point of Don's. There is a continuing reiteration that the consent decree does not do anything with rates and per se it does not specify any increase, but there are, as the gentleman down there said, there is so much confusion on the thing, it is unclear, and so that it opens the potential for rate increases that we have talked about, and I think the very least you can say about the consent decree is that it will greatly accelerate the changes that are taking place in our environment.

I will give you a specific example, CPE. The FCC has recommended a phase-in over a 5-year period, and if I read the consent decree properly, it does it in 18 months, and that means that we are going to take the same step in a much shorter period of time, and that takes—it is much more difficult to adjust your revenues in the shorter period, so I think the least we can say is that it is going to accelerate this increase.

Mr. VanAllen. Could I clarify something? It was not my statement that the consent decree does not change rates. It does not of and by itself increase local costs. Now, the rates will obviously have to change. That is a part of the consent decree, substituting the local access charge for the subsidy from long distance, so it was not my statement that it would not change rates. They will change in their structure.

Senator Cannon. I did not interpret Mr. Holmes as saying it was your statement. I think he said it seemed to be a consensus. Wasn't that what you were directing it toward?

Mr. Holmes. Yes, Senator, and the point he brings up of cost is one of the key factors in this thing. As another person once said in a lecture regarding costs, costs are as they are defined, and they are defined to the benefit of the definer, and that is what we have here. We do not know what we are talking about in cost-based rates as it talks about in the consent decree. Now, cost as we talk about it today of John Christian's, as he presents costs to Bell for settlements, those costs are, shall we say, inflated by the process that we have used historically through the Ozark plan of settlements, and that is a legitimate cost as recognized, but if we change the definition of cost and go toward what is being inferred in the consent decree as cost-base rates, that is the actual incremental cost of handling a call.

In the long-distance arena, we are talking about something radically different. We are talking about in the State of Nevada contributions in the past in excess of that for a level of in the neighborhood of 65 to 70 percent on a statewide average. So, we have been loading, if you will, these costs in, and I am not saying that is appropriate. I am just saying that that is a fact, and we have to adjust backward out of it if we are going to pursue this course, and we need to adjust carefully.

Mr. Guinn. I do not want to dominate this, but I would like to make a tag-on to John's first statement, which I did not get to, and that is the capital recovery he spoke of, one form of which is expensive station connections. I think the FCC provides a 4-year phase-in by the States. The California Commission, for example, last year embraced this and gave us a flash cut phasing all at one time. It is true that that did raise rates in California now, but that is going to save us the financing of $440 million this year as a result of getting those station connecting rates.

Over time, those capital recovery items will lower rates, because we will not have to raise that money in a very high cost market rather than raise rates.

Senator CANNON. You are really saying that you have a prepayment situation there which will result in keeping the rates down.

Mr. GUINN. Absolutely.

Senator CANNON. Well, the basis of most predictions that local rates will increase is the assumption that long-distance users pay more than their share of the cost of the service, and hence help keep the local rate down.

Now, I would like to ask Mr. Kushan to address that issue from his perspective as a long-distance carrier.

Mr. KUSHAN. As a competitor, sure, Senator. There no doubt is some subsidy flow from interstate long distance to intrastate services. There is a big question as to exactly how those revenues are used. I think in Mr. Christian's testimony he stated there was about $154,000 out of $1,640,000 of that subsidy revenue that flowed to support customer premises equipment. Here is an example, a precise example of a subsidy being used to support a competitive service. Mr. Smith, of Executone offers competitive equipment trying to compete with Mr. Christian of Lincoln Telephone who is using long-distance subsidy revenue to offset the costs of competitive equipment.

One problem we have in the industry today is that we have subsidies flowing to support competitive services and in effect a large chunk of the money that came from interstate did not go to support local service rates at all. It went to support the cost of equipment, the customer premises equipment in businesses and in residences. This just has to change.

There are some other aspects of the subsidy flow. There are certain reverse flows that go back. I do not know the amount of license contracts payments that flow from Pacific Telephone back to A.T. & T. or from Nevada that flows back to A.T. & T., but there is a significant amount of money just as a McDonald's franchisee pays the corporation, there is a significant amount of money that flows from each of the Bell operating companies back to the headquarters just for the benefit of having the franchise.

When you net all these cross-flows back and forth, there is a large question just how big that subsidy amount is, and if there is a flow, that goes to support intrastate services. Does it really in fact support local service rates, or does it support competitive equipment, or does it support other competitive services, such as intrastate private lines, and there is ample evidence to show that it does support that.

So, yes, there are revenue flows that go back and forth. A.T. & T. is the keeper of all those numbers. We do not have access to them. One benefit of divestiture, I think we will get a better view of just where those moneys are flowing. The license contract fees, separations, settlements, it takes that whole process out of the hands of A.T. & T. and the existing industry and puts it into a public area where it can be scrutinized.

By the way, I want to make one further point clear. Our position has always been in Southern Pacific Communications, both in the Senate and on the House side, looking at legislation, that we support the subsidy requirement, and we are willing to pay subsidies to support rural and remote areas and needy customers, and so long as everybody is paying that on the same basis, we have no problem with doing it, and we support that approach.

We just think that everybody does not need subsidy.

Senator CANNON. Well, I think that this, though, is one of the gut issues, one of the key issues, as far as we are concerned out here. Now, I think you pointed out, perhaps quite rightly, that John Christian's rates are a little unduly low based on the service that is being made available.

Mr. GUINN. That was not my intent.

Senator CANNON. When you consider what other customers are paying. But be that as it may, I am sure that everyone would recognize that he cannot go in and ask for a 400-percent increase in his rates and still supply rural Nevada. And I am sure that that would apply to the other companies, although I was kind of struck by the chart that was put there, if I can find it in a minute. Where is that chart? That chart, I was rather interested to see that the estimated rates here—I cannot understand why Moapa Valley Telephone Co. would have a rate increase of only $8.73, and yet Lincoln County and Churchill County would have over $20 each. It would seem to me that those service areas would probably be pretty comparable costwise and ratewise.

John, can you——

Mr. CHRISTIAN. Senator, one reason that ours is so high, as I mentioned, we have 10,000 square miles to serve, and 1,310 customers, and our average cost per user is extremely high because we are so spread out in this area.

Senator CANNON. How about Moapa Valley, though?

Mr. CHRISTIAN. Moapa Valley is more concentrated. Their facilities are around the Moapa Valley-Glendale area. Their service area, I am sure, is not as large as what we are serving.

Mr. HOLMES. There is another factor here, Senator. When Moapa Valley settled, they settled with Bill McGrew. They did not settle with Dick VanAllen. And that is one of the major factors shown there, more than who has the concentration. They settle with Centel, and whereas John settles strictly with Bell. There are a lot of numbers that jump around in here because of that process, and that points out the very thing that we are talking about here is the separation settlement process.

I might want to go back to one of Don's comments. He was talking about expensing station connections. I was not referring to that at all, but rather the CPE phaseout in the separations process, which I believe is 5 years. So, when you start looking at these things, there are a lot of things that can skew these numbers one way or the other. They are given as an example, and I specifically put Moapa Valley in there to demonstrate the contrast depending on how you settle, with whom you settle, and what the calling habits are.

Not only do we have the sparseness in this State, but we have a peculiar thing. If you look at the State of Nevada, the majority of our population lives around the border of the State, and their area of interest often is greater outside the State border than inside the State border. That is why we have such a historically high interstate calling pattern, and that is what has generated this subsidy flow over the years, and what is being taken away is going to change the rates radically.

Senator Cannon. You have been giving Mr. McGrew pats on the back. How do you explain the fact that Rio Virgin Telephone Co. would have to raise over $20? Do they not settle with McGrew now with Centel?

Mr. Holmes. No, sir.

Senator Cannon. Who do they settle with?

Mr. Holmes. Bell.

Senator Cannon. I see.

Mr. Holmes. In fact, they do not even settle with Dick here. They go across the border and settle a lot of it with Mountain Bell. That is not even in our State. So, again, you get an example of how your calling pattern and the methodology used in this thing that so hard to define, cost, can jump those figures around.

Mr. Guinn. Senator, could I respond to what was said by Southern Pacific?

Senator Cannon. Surely.

Mr. Guinn. First of all, the license contract, because it is a simple issue, we do not pay that like a franchise or a franchise business. We pay that as though it was a service bureau for services we receive on a current basis, and we have examined that and analyzed it time after time after time, and it has been very carefully scrutinized by every commission in the country, including Bell of Nevada's commission in our case. And we always conclude that is an economic way to get these centralized services. That is not a franchise payment, it is a payment for services rendered.

Under the divestiture, there will still be something probably like that existing, but it will be owned by the seven regional companies and they will pay into it so they can get central services.

In terms of the access charge itself, I think it is important to recognize that the earnings base is currently being eroded badly and by the other common carriers in support of the local exchange tariff. In 1980, for example, we estimated that we lost about $50 million to other common carriers. In 1982, we estimate that is going to be around $200.

Senator Cannon. How much?

Mr. Guinn. Around $200. That is for the total company, Pacific and Bell of Nevada.

Senator Cannon. $200?

Mr. Guinn. $200 million.

Senator Cannon. I was going to say you made a tremendous recovery.

Mr. Guinn. I wish it were so, but in addition to that, in 1980 we provided roughly 8,000 exchange network for intercity access service rate now paid by other common carriers to get access to the customers. We have about 8,000 of those in 1980. At the end of this year, we expect we are going to have about 18,000, and we have demonstrated in FCC hearings that those rates are not compensatory. In fact, some elements of them are less than 55 percent, and as a result we are losing revenues to the BOC's, as I demonstrated, from $50 million to $200 million in 2 years, and we are also hooking up significantly more circuits for which we are subsidizing the other common carriers and the people who are subsidizing that are the Bell System and the other independent companies.

So, the phenomenon is there, and what the consent decree is trying to do is to make it more equal.

Senator CANNON. Let me recognize Mr. Smith. He had his hand up a few moments ago.

Mr. SMITH. Thank you, Senator.

I was going to support to some extent Mr. Kushan's remark with regard to the license contracts and other factors which are often cited as being supportive of the argument that the lack of subsidy in long distance will raise local rates. I think there has been lots of evidence around that the subsidy flow in some areas, at least, has been the other way, from the operating companies to A.T. & T. and the Bell System rather than back the other way. One is license contracts.

In 1980, the Bell operating companies paid the Bell System $1.3 billion for various administrative, basic R. & D., engineering, legal, and advertising services. William Baxter, Assistant Attorney General, has testified that the amount is too large, and that it has siphoned away revenues from the operating companies that should have stayed there. It has been demonstrated also to several State utility commissions that license contracts hurt both the competitors, allowing the Bell operating companies to subsidize basic R. & D., for instance, and consumers who are forced to pay the subsidy.

Second, with regard to the standard supply contracts, in 1980 the Bell operating companies bought about $10.2 billion in equipment from Western Electric, which was about 96 percent of its needs. There has been an awful lot of evidence in the antitrust trial to show that A.T. & T. forced the Bell operating companies to buy inferior Western Electric equipment at inflated prices rather than allowing the Bell operating companies to shop for other perhaps more competitive equipment.

It is our understanding from looking at the settlement that both of these subsidies would end under the conditions of the settlement. If that were to occur, obviously, if those subsidies are flowing the other way, it would provide some relief to local ratepayers.

Senator CANNON. You wanted to——

Mr. KUSHAN. Yes. Just a few comments. I will go back to what I said before. The amount of the subsidy and the direction of the flow, if we assume even if it is positively toward the local operating companies, I will say what I said a while ago, most of that subsidy has been out there flowing to support services which are competitive in the Bell operating companies. That is the CPE, customer premise equipment, and competitive private line services.

There are studies that substantiate this, and I think Mr. Holmes of the Nevada PUC could substantiate that.

The second part I want to get to is the malarky that Mr. Guinn put forth about the fact they are subsidizing the other common carriers. Most of the issues in the antitrust case related to the inferior access and the way the Bell operating companies have treated the other common carriers. It is a known fact, as testified to by myself and many other people, and as quoted in Judge Greene's response to A.T. & T.'s motion for dismissal of the suit in September, that they had been found guilty of giving us inferior access, abusing the other common carriers, making life difficult for us. We do not have equal access.

Without going into the litany of the differences why you have to work so hard to use our services as opposed to A.T. & T. Long Lines services, it is just an obvious fact, and it is testified to. As long as we are not getting that equal access, and as long as we continue to get inferior treatment, I do not see how anybody could expect us to pay the equivalent, the same price that A.T. & T. pays to its local operating companies for access to the long line network.

It is not even realistic to envision that. The courts have agreed with that. The antitrust settlement itself, a large part of the issue of the antitrust settlement addressed that problem, and they guarantee us until 1991 certain advantages that have been denied us because of the way they have dealt with us. So, you know, I am just tired of the malarky about it, and how anybody from any Bell operating company can sit there and say they have been subsidizing other common carriers, it is just ridiculous.

Senator CANNON. Mr. Holmes, let me ask you, would you feel more comfortable if the State regulatory commissions had exclusive jurisdiction to set access charges?

Mr. HOLMES. Yes, sir, I would, and that would not be an easy task. The thought process that probably comes to mind is, aha, yes, and they had set it to the same degree that the subsidies had been reporting, like John Christian, and therefore keep it very high, and everything would be cushy and nice, and there would not be any change in local rates.

However, in the environment that we have been thrust into, which is a quasi-competitive environment, if we are to look at the total picture in selling that rate, we have to address the problem of bypass, unless there is legislative prohibition of that, and that is that if John sets his rates to the level necessary to recoup all of that subsidy right now, he is not going to have too many people anxious to pay that fee to get into his network, and therefore anyone within his boundaries could easily put a dish on the roof, bounce off a satellite, and say, good-bye to Lincoln County Telephone Co. That can be done on a larger scale. It can be done to—Dick VanAllen here with Nevada Bell. It is being done. It will increase if we do not carefully construct that in the competitive environment or pass legislation prohibiting that bypass.

And that worries me. It really does. But when you get down to the essence of your question, do you think we should regulate it or do we think FCC, I only ask you, Senator, if there is a problem about the rate structure or anything else, in Mina do you think that somebody in Carson City is better able to handle the problem or in Washington, D.C.?

Senator **Cannon**. As I stated in my opening remarks, one of the most serious concerns is related to the viability of Pacific Telephone. Even if Nevada Bell is treated as a completely separate entity, for regulatory purposes, for the purpose of raising capital, obviously, it would not be. If Pacific Tel has poor credit rating, this would make the cost of obtaining debt and equity capital substantially higher than it might be if Nevada Bell were affiliated with another local operating company.

My first question is directed to the Bell witnesses. How firm is this regional structure plan, and what are the prospects that Nevada Bell might be included in another region?

Mr. **Guinn**. Senator, I will respond to that, and then maybe Mr. VanAllen can. But, first I think I must respond a bit to some of what Jeff Kushan said, although I will try to use less inflammatory language. I am not sure he is aware that the other common carriers were offered under the auspices of the FCC staff—in order to be sure of the legitimacy of it—the opportunity to have complete technological parity on their access about 2 years ago. When they saw the price of that access, they rejected it.

Now, I am not certain why they did that, but I would assume that their rejection was predicated on the basis that that increase in cost would cause them to lose a great share of their marketing opportunity. So, the facts are still as I stated them. They certainly do not have parity today, but they do not pay an equal cost for that, either, and when they were offered parity under the auspices of an FCC staff proceeding, they turned it down.

Mr. **Kushan**. I have to respond to that.

Senator **Cannon**. I do not want to spend all day on this.

Mr. **Kushan**. I will not bore you with it, but it was completely illogical. Yes, I was a party to the negotiating process.

Mr. **Guinn**. I was, too. I was involved at A.T. & T. Let us go on to the next subject, Mr. Holmes' question about viability. There is no question that Pacific Telephone has had a difficult financial road, more difficult than some of the other operating companies. At the same time, I think it is important to put that in its relative position. We are still an A rated company. That is very important, because in seeking capital in the bond and debt market you have a great deal more availability to capital if you are rated in some form of A, AA, or AAA, than if you are rated BBB, because many institutions are precluded from offering their debt to any firm that is related below A. So, having an A rating is still one of the best ratings in the country.

At the same time, there is no question that we have had a difficult financial road. There is no question that we have had difficulty in the past working out an appropriate relationship with the California Public Utility Commission, so that they were persuaded to give us adequate rate increases. However, I am pleased to report to you that in 1981 they gave us a very appropriate rate increase, more money in total than we have gotten in over 10 years. Right behind that they gave us the expensing station connection order a few months later that I referred to earlier. That has not restored our financial health, but it has helped a great deal. We are clearly on an improving trend.

One of the important things about a credit rating is to assure your availability to debt and equity at reasonable cost. So this is a two-part problem. One of them is to improve your credit rating, and we are doing that. The other one is to reduce your appetite for capital. On the average, in 1980 and 1981, we raised about $1.5 billion each year in the external marketplace. A little higher in 1980, a little less in 1981. This year we would expect to raise somewhere on the order of $800 million. So, part of the solution is to get the capital recovery items—like expensing station connections—that reduces your need for capital.

The important part is that, in 1981, only 45 percent of our construction budget program funds came from external sources. This year it will be somewhere on the order of 75 percent. That is a significant difference. Also, Nevada Bell gets a tremendous amount of advantages by being associated with Pacific. They only pay their share of what goes on in the headquarters organization. Just for example, when we raise debt, they have no cost of raising debt, because Pacific raises it all. Everything we finance here in Nevada is capital. When we do any kind of methods and procedures work, that will be beneficial to both urban and rural customers, Nevada gets the benefits of that.

So, I think being associated with Pacific Telephone is very advantageous. In addition to that, we have over the years managed Nevada Bell separate from California because they are different. The regulatory processes have been different, and Dick VanAllen spoke to that already. Nevada has nearly 77 percent ESS by the end of this year. Pacific will have 50 percent, which is about the system average. We are moving ahead aggressively with some of those modernizations in Nevada, because of the working relationship with this commission.

So, I really believe that this has been a good marriage. We have always been very careful to keep a chief executive officer in Nevada as vice president and general manager, as Dick is now, to run our affairs over here. Dick has the full responsibility and accountability for the State of Nevada, for Nevada Bell.

So, I would think that the benefits that accrue from that relationship are as good or better than they would be in any regional holding company, and we do not have the problems of making a change from our present organization.

To your last question, how firm are the regional holding companies, that is a planning model that has been put out so that other planning work can be done. It is a front-end consideration that has to be decided, and obviously, as a planning model, it is subject to change, but I think at the moment we believe it is the right relationship.

Mr. VanAllen. I might just comment, Senator, on that, too. If you look back in the past, Pacific Telephone has treated Nevada very well in terms of not only the kind of staff work that they had provided us and this has allowed us to have minimal sized staffs, because we could ride on what they were doing. Also in terms of capital, all through the times when they have had some difficulties, and been able to or been forced to pull back from investment decisions, we have gone right ahead and invested the way we needed to. So I think, it was a totally separate consideration in terms of Nevada.

Senator CANNON. Well, Dick, I am happy to have that, but I would not expect that you would say that you have not been treated well by Pacific.

Mr. GUINN. I think, Senator, our record shows that is the case as well, in addition to Dick saying it.

Senator CANNON. The PSC argues local operating companies, in our case Nevada Bell, will be unduly hampered by the proposed settlement by being limited to the least lucrative part of the telephone business while being prohibited from getting into other areas. Would anyone like to comment on that?

Mr. GUINN. Well, that almost gets to the question of, is the consent decree the right way to solve this problem of the emerging public policy in the United States? I think most of us in the Bell System—I can certainly speak for myself and, I believe, Dick, because we have talked about it—we would like to have it the way it was. We thought for 100 years we provided the best telephone service in the world at the lowest cost, but with the advent of the changing telecommunications policy, we have gone beyond that.

So, when you finally get down to trying to find a solution, the premise of the consent decree, it seems to me, is to endeavor to put the portions of the business that are competitive under A.T. & T., and the portions of the business that should stay regulated under the local operating companies.

Now, there is one aberration to that. That is the intercity toll which is regulated. But with the advent of other common carriers in intercity toll, it may not be necessary at some future time even to regulate A.T. & T. there. So, I think it was a matter of trying to find the best division of functions. Once you do that, then you have to look at, on that basis what can you do. We are still going to be a very large company. I do not know how many, 70,000 to 80,000 employees in total between Nevada and California, $11 billion worth of assets, a strong customer base, highly experienced and very competent employees, a widely deployed service capability, which is something that is important to have in a marketing situation.

So, I believe, as I said in my testimony, that the Bell operating companies have every opportunity in the information marketplace, and of course the need for information, the need to handle information is growing very rapidly. The key in my mind is to not get the access charges so high that we invite bypass, because if we do not, no matter which terminal company prospers or no matter which intercity company prospers, the local exchange company is going to handle that business in their local exchange switching and transmission equipment.

Mr. VANALLEN. I think I might just add onto that. Bill McGrew mentioned some of that in his testimony, but this really makes the advent of more usage sensitive rate structures more important, so we can participate in the growth of these other carriers by having more connections to our local facilities, regardless of who the carrier is, and we will really be in a position to market usage of the local exchange facility.

We are on a flat rate basis now so it really just costs more with no more revenue. It does make a change to usage based pricing a very appealing one.

Mr. GUINN. Senator, one final point I would like to make sure I make. It is extremely important that we get to the usage sensitive pricing for many reasons, but let me just describe one situation. Let us assume that some other common carrier or A.T. & T., because they will be functioning essentially the same, would not provide, or have for whatever reason, adequate trunking at some point in time, and a customer has chosen to use their service. He dials through the local network, reaches the other common carrier, but cannot get onto that carrier or cannot get to the place where he wants to get. So he hangs up and dials again. All of those attempts and carrying all that traffic costs us money, and unless we get revenues from each of those attempts, there is going to be no incentive on the part of the customer to wait a while, dial a different carrier, or whatever.

The same thing is true in premises equipment. To the extent that a customer, from whatever equipment vendor, A.T. & T. included, does not have adequate trunks to terminate into his premises equipment; we carry the call all the way through the local network, and we get nothing for it.

So, we do need clearly to get to usage sensitive for many reasons. What I just described is not only true for us but it is true, and I think Centel said the same thing for them as well. The changing arrangement in which we will use the telephone network is going to require us to price on the basis of usage.

Senator CANNON. Jon?

Mr. WELLINGHOFF. Senator, if I could comment on Mr. VanAllen's statement, I tend to agree with him. In reading the consent decree, I think there is potential there. I more or less put myself through school in the grocery business. We used to call them cherrypickers. They would come in and buy all the sale items. They would not buy anything else. I see the potential of A.T. & T. doing the same thing, and I would like to ask Mr. Guinn about one other aberration, as I see it. It is my understanding, potentially, A.T. & T. would take the classified directory advertising. I would like to know his opinion, whether or not he thinks Pacific Tel & Tel should maintain that or A.T. & T. should have that.

Mr. GUINN. Well, Jon, that is a very difficult question to answer out of context. I would say that I would like to have all the revenues we have always had, but that is behind us. In terms of taking yellow page revenues, I think you have to say in terms of the consent decree, how does it fit? The concept of the consent decree is competitive. We have 168 competitive yellow page directories in Pacific Telephone and Bell of Nevada telephone area today, so I think yellow pages is truly competitive today.

It seems to me like we at some point in time need to get out of the courts, and out of the halls of Congress, and out of the FCC, and back to running the telephone business. If it is competitive, and if we are still going to have to face the issues of cross-subsidy and other things because of it, then it seems to me where it has been placed is correct.

Also, as has been stated by a number of people, we do have the white page machine readable listings which we can sell to others. We have the capability of offering to anyone that they co-bind their yellow pages with our white pages, which I think would give them a very substantial marketing opportunity. But we have not had any chance to evaluate what the value of that is at this point in time.

Senator CANNON. One of the issues raised by the PSC is that the cost of equipment purchased by the local operating companies may increase rapidly. The premise for that argument is that Western Electric's prices for nonterminal equipment is about 20 percent below the prices of other suppliers, and that Western Electric is likely to increase its prices after the settlement.

I would especially like to hear from Mr. McGee and Mr. Smith on that point.

Mr. McGEE. Senator, the pricing issue out of Western Electric, the best information we seem to be able to find in the general trade area is that your comment regarding their lower prices in the large generic areas, is possibly so, that is the way they report it, but in specific equipment areas, we have seen many, many times in many cases where Western Electric's prices were not competitive with those similar products or equivalent products that were available from the general trade.

Typically, across the country, in the Bell operating companies, evaluations of general trade manufacturers' equipment, with all things equal with the product and Western Electric's, our pricing will have to be approximately 8–11 percent underneath Western Electric's price before we break even during the evaluation.

This has to do with the cross-licensing and the cross-subsidy of development, marketing of product, et cetera. Consequently we see Western Electric sitting there, from our point of view, in a highly monopolistic situation, with the in-built ability through the consent decree to continue that position.

Senator CANNON. Mr. Smith, do you have anything to add on that?

Mr. SMITH. Not much more, other than that the studies we have looked at would support the view that was just presented. It is almost impossible for anyone, if you look at telephone exchange rates for CPE equipment across the country, to understand that Western Electric is charging each operating company equally for the same piece of equipment. The variances that you see are very, very wide on occasion, and it is hard to understand that all of those variances are caused by local conditions, and not perhaps by the fact that Western Electric might charge one price for a piece of equipment to one Bell operating company and a different price to another operating company.

Now, what does that say about Western Electric's pricing? Well, it may open a Pandora's box, perhaps, but it certainly is a significant question that has been asked before.

Mr. DEBOIS. May I respond briefly? I have been uncharacteristically quiet.

Senator CANNON. Sure.

Mr. DEBOIS. With regard to Western Electric, I think, contrary to what has been said this morning, that the record will show that there has been no forcing of the operating companies to purchase Western Electric equipment through the years. I think Mr. Guinn can tell you about the purchases that the Pacific company and Bell Nevada have made outside. In 1981, for example, tremendous strides. I think that people who say we charge one price to one operating company and another to another do not understand the standard supply contract. We would be in violation of that contract. It requires that we sell to all operating companies on the same basis, the most favorable price.

With regard to the question of whether or not divestiture will force Western Electric prices up, I would think that if you believe that there has been any untoward pressure on the operating companies by virtue of the fact that A.T. & T. owns the operating companies and owns Western Electric, and I do not believe that for a moment, obviously, one of the purposes even for the skeptics of the divestiture is to remove that control, so that the BOC's unquestionably will have absolute autonomy to purchase the equipment, and that should force by competition prices to the most reasonable level possible.

If I might also comment on one other statement that was made with regard to the license contract, the license contract not only is not a McDonald's franchise, but it is a payment for services of great value, and it is a payment for the cost of the services. I do not want this hearing to end and for the Senator to go away and believe there is any markup for profit in the license contract, because there absolutely is not.

Thank you, sir.

Senator CANNON. In his testimony, Mr. Holmes expresses concern that it would be very difficult for telephone customers to obtain repair service under the new system. Do any of you have any comments on that?

Mr. GUINN. Well, I would share John's concern about repair service, depending on which of the various scenarios we finally end up with. The FCC Computer II inquiry has a bifurcated approach to it. There is a different requirement in S. 898. I have not seen the final amendments on the H.R. 5158, the Wirth bill that came out of subcommittee today, but it requires, as somebody spoke to, an entirely different arrangement.

I think it is going to be difficult for customers to understand and to relate to, and I think it is something that is going to challenge us all to manage it. However, I think our track record is that the coalition of the independent telephone companies and the Bell System have been able to manage every opportunity that has been presented to us in the telecommunications field, and I think we will manage that one.

However, I think inherently it is going to be a bit more difficult when the customer has to look to different people for repair, as they will under any of the scenarios that I am aware of that is on the table today.

Mr. SMITH. May I respond to that?

Senator CANNON. Yes.

Mr. SMITH. We sell telephone systems that are installed in customer premises. Those are connected to Bell System's trunks or lines, and we are responsible for maintaining those systems for our customers. Recently the telephone companies across the country, at the urging of the interconnect side of the market, have created COG groups, essentially groups within the Bell System to interface with us as outside suppliers. These have largely been very, very successful.

We instruct our customers that when they have trouble with a telephone system that we have furnished, they are to call us. We go through our diagnostic routines and fix the trouble, or work closely with the Bell operating company in the area to correct the problems.

Generally, this arrangement works out very, very well. We get good cooperation from the Bell operating companies, and I would think certainly that if we can as a direct, nonrelated competitor, achieve that kind of cooperation, that that could be achieved between the baby Bell companies, if that is what they are referred to, and the local operating companies, with very little difficulty. It certainly is not a difficult proposition for us now, although it was at the beginning of our industry 10 or 11 years ago.

Mr. GUINN. I am not speaking to the kind of arrangement that was just described. I think we can all learn to make that work and we have. I am speaking to the kind of bifurcation arrangement. To just give you a for instance, a residence customer at some future time could have a Bell telephone, a telephone they bought from somewhere else, or from other suppliers. When they call repair service, the first thing we have to do is determine whose telephone is in trouble, or whether it is the telephone or something else, and then which telephone is in trouble, and then where they go to get it repaired.

Again, I think we will find ways through that. That is not an impossible problem. But I am not speaking to the kind of situation where you would have a cleancut separation—where you would then put A. T. & T. out in the terminal business like other vendors, and we would all relate the same way. It is this arrangement, the so-called bifurcated arrangement, that is extremely difficult. I think someone referred to it this morning—I guess it was Bill Smith—that is in, H.R. 5158. I have not seen that provision.

It has some kind of a provision where the regulated company would offer both existing and new service for a couple of years, and then they would only offer embedded, and then they would try to get back in after 5 years if they wanted to, into a very competitive business that all kinds of other terminal manufacturers have been in for a long time.

I think that is an awkward arrangement as opposed to a cleancut division in which A.T. & T., to a customer, looks just like any other terminal vendor. I think that is a better arrangement.

Senator CANNON. I indicated in my opening remarks, of course, our interest from the standpoint of our tourism industry. I would like to ask any of you, how will the State's tourism industry be affected? Will we see new competitors in the field of long distance services, or what do you anticipate?

Mr. MCGREW. I might address that, Senator. It is not what we see, it is how much we are going to see, and it is moving very rapidly into a bypass type of situation, a resale type situation, and it in turn is having quite an effect on our toll and the total overall picture of the toll handling.

Senator CANNON. Is that a good or a bad result? You are saying you are losing some revenues, but what is the overall assessment as to how it is going to affect our service in that area?

Mr. McGREW. The overall assessment is, again, the effect on the revenue situation and what the companies will have to do in regard to supplementing that revenue, and insofar as I can see, we probably are most vulnerable here on the bypass situation, and this is strictly talking about the bypass. This is not going into a network where there is any ENFIA type settlement. It is not going into a network of A.T. & T. whereby we in turn participate in the settlement there. This is strictly a bypass of the entire network, and this is going to affect those that are in turn involved in the tourist business here in Nevada.

Senator CANNON. Does anyone else have any comments on that?

Mr. HOLMES. Senator, I would like to speak to that. Bill is speaking from the point of Las Vegas, and he is certainly correct there, but as we look at it from the commission, the overall State process, I think we are going to be one of the last areas in the country to benefit from competition, I mean totally in the State, because Jeff here is probably interested in Las Vegas and Reno, but I do not think he is going to be rushing to get John over in the corner as soon as we leave to get into Pioche. We have to look at the State as a whole as benefiting from it, and I think that that is one of the problems facing us.

What this thing really boils down to is, those people out there, they are all paying all of these different costs. They are choosing to go with A.T. & T. They are choosing to buy their phone at Radio Shack. They are choosing to use Sprint. They are choosing a number of different things, but they are paying the total telephone bill, and what we are playing with here today is how they are going to pay that telephone bill.

In the past, we have said that the entry, the demand charge, you can use some of the industry, other industries 'correlated approach has been very low, you can get into the network, you can have access to it very cheaply, and then as you use it incrementally you pay a higher charge. The scenario that seems to be developing is, we are going to pay a much lower incremental charge for the use of the network in the long distance area, and a much higher entry fee, and you can—it is all going to wind up to be dollars.

You know, when I was in your office a little over a year ago with John Christian, you said, give me some specifics, and I brought with me my phone bill that I just received yesterday, and if we look at the price, we talked about some low charges, but not everyone pays that low charge that was quoted. With Nevada being a rural area, many, many people pay mileage charges on top of that fee that I told you. Now, you can say, I live out in the boonies, being halfway to Genoa from Carson City, but I am only 5 miles from the capital, so relatively speaking in Nevada I am not really out in the middle of nowhere, and with a mileage charge for one basic rotary phone at my house, I pay Continental Telephone $24.25 a month.

I would not say that is unreasonable based on cost, but if you add to that the possibilities outlined in here, if you add another $23.59, you are talking about $48 a month to get a dial tone. That is a considerable amount. I look at the rest of my bill, and I see where I called my mother in Maryland, my grandmother in South Carolina once a week, and I talk to them for quite a while, and I see bills in the neighborhood of $1.50 to $2.50. Now, everyone tells me that that is highly profitable, and I do not doubt it a bit, but when I look at my choice of paying $50 a month for my basic service, and maybe only 25 or 30 cents for that call to my mother, versus paying $25 and paying $1.50 to $2.50 if I choose to call, I obviously would pick the latter.

I think this is where it really revolves around what we are faced with in this State.

Mr. VANALLEN. I just might comment, that is the crux of the problem. As you open things up to competition, you start driving a very profitable part of our business toward cost, so you may get the cheap toll charges, because that is an inexpensive transaction compared to what it costs to place those calls. Then you get your $24 because you live out there, and the cross-subsidy is much more difficult to come by when you start opening it up to competition. That is why the access charge level will be so important as a replacement for, in effect, the lost profit from the long distance.

Mr. HOLMES. Senator, we are talking about——

Senator CANNON. All right. Add whatever you have to add there.

Mr. HOLMES. I do know there was some discussion previously about the amount of money being lost in this thing. We are talking about a huge chunk of money, $21 billion in the Bell System generated by incremental message charges in a year. That is a lot of money. I put that in perspective with the $50 million less.

I might note that Jeff and Don were going about—and when you start to look at this on another basis, if you take all the times that the telephone is picked up in the Bell System, 7 percent of the time they are making a toll call, 93 percent of the time they are making a local call. Of the revenues generated, on an incremental basis, naturally, the toll calls and some message unit calls in some areas generate this $21 billion, or, another way to look at it, 92 percent of the revenues developed in the system come from 7 percent of the messages.

Now, we have created that imbalance situation, and now we are going to divvy this thing up between the BOC's and the carriers, and we have a bit of a problem. You asked about whether the BOC was going to wind up on the short end of the stick. Which would you rather have, the part that was getting 92 percent of the revenues or the part that was getting the other part?

Senator CANNON. Well, I think you have to factor in the cost as well. That is a big factor. You cannot just say we are getting more revenues from a smaller number, if your costs are comparable at all.

There is one more witness that has been requested to be heard, Mr. Pat Cashill, representing Edwards Industries.

Do you want to step up there, Pat, to the microphone?

STATEMENT OF PAT CASHILL, EDWARDS INDUSTRIES

Mr. CASHILL. For the record, my name is Pat Cashill. I am appearing on behalf of Edwards Industries, a Sparks-based Nevada corporation manufacturing and selling interconnection equipment utilized largely for the interconnection of microwave systems to the Bell network. Events which triggered the proposed settlement now before Judge Greene, as Judge Greene's denial of A.T. & T.'s motion to dismiss the Government's case, which is presently pending in his decision. Judge Greene found that the Government had proved that A.T. & T. had engaged in anticompetitive conduct in a number of respects, including the use of predatory pricing, largely through the channeling of revenue, tariff-protected revenues into the field of competitive sales and the provision of services.

In addition, the judge found an abuse of the administrative process by means of delay tactics employed before the FCC utilized for the purpose of preventing certain competitors from entering the market. We are concerned at this point, Senator, that the proposed settlement will not encourage competition, but will preserve the anticompetitive environment which now prevails. We have a number of suggestions.

First, that the Federal Government legislatively preempt all matters concerning interconnection. That is, that the FCC be empowered to promulgate regulations, tariffs, and other matters pertaining to the interconnection of equipment and the provision of interconnect services.

Second, legislation should be adopted compelling the adoption of tariffs by the 50 States of a uniform nature, that is, to prevent an unstructured, sporadic, nonuniform system of tariffs from applying to the efforts of companies across the Nation from interconnecting to the network. We have been faced with in this State tariffs which are inconsistent with tariffs in other States in which Edwards Industries markets.

Our marketing area is the western mining area. The thrust of Edwards' efforts is to sell equipment and services related to microwave equipment. In our business, in our territory, the microwave equipment is highly structured to the utilization by mining companies, by remote communities. For instance, in Nevada, there are towns, there are Indian reservations, there are mines located in some cases scores, sometimes hundreds of miles from the nearest point of interconnection. The provision of land aligned services or poll strung or buried cable simply is not possible. Microwave is the key.

We suggest, Senator, that some effort be made legislatively to provide a mechanism through which tariffs can be adopted on a uniform basis at the Federal level, and then mandated to be adopted at the State level. We suggest, Senator, that because of manpower and budget restrictions, the PSC here in Nevada is sometimes unable to give the attention it could and should to the adoption of tariffs. It relies in large part upon the efforts of Nevada Bell. That, to a large extent, in the past has proven to be the fox in charge of the chicken coop.

Finally, Senator, we would request that cross-subsidization be outlawed in its entirety. Judge Greene has found that Bell has taken protected revenues and channeled those revenues into competitive areas, enabling Bell, its operating companies, Western Electric, to sell product and services below actual cost. Unless that conduct is prohibited, unless cross-subsidization is totally outlawed, there is little protection for the competitor who seeks to compete on an equal level against Bell.

Thank you, Senator.

Senator CANNON. I thank you for your testimony.

I do not know if you heard all the testimony or not, but certainly based on what we heard here today, I think if cross-subsidization were done away with completely, you would completely destroy telephone service to rural America as well as rural Nevada, and I cannot subscribe to that kind of a proposition that is going to destroy rural telephone service either in the State of Nevada or nationally.

Mr. CASHILL. Nor do we, Senator.

Senator CANNON. You made the suggestion that we do just that.

Mr. DEBOIS. He said in his opening remarks that he made that he was talking about Greene's ruling on a motion for summary judgment by the Bell System defendants, and then he went forward and said that the judge had found this and found that. Obviously, all he was doing was finding that the Government had come up with a prima facie case that withstood a motion for summary judgment and his judgment then was withheld for hearing from the defendants, and the case, of course, has been settled short of ruling on the evidence of the defendants.

Senator CANNON. I understand that.

Mr. CASHILL. Thank you, Senator.

Mr. GUINN. Could I add one thought about the uniform charges? I can understand why that may be desirable for some people in these marketplaces, but I think it is highly undesirable for the average consumer. We have gone far enough in our preliminary looks at access charges since the consent decree to know that there are some places where the costs are significantly less for access and some where they are significantly more. If we do not have some differentiation between costs, we are going to invite significant bypass of the local exchange, perhaps more so than the intercity, in my judgment.

The consent decree philosophically recognizes this by allowing subzones for pricing of access charges within exchange boundaries. Everything we see so far says that is a vital and necessary provision.

Senator CANNON. Well, I think that is one thing that I guess most of us here could agree on, that statement.

I will, as I said earlier, see that the hearing record is held open for 2 weeks in order to allow the opportunity for any other interested parties to submit testimony, or to respond to some points that have been made here today.

I want to thank all of you for appearing here, and giving the committee the advantage of your views. I think it is really important that we make this record complete, and as you know, this whole issue has a long way to go in light of the court decision yet to come, and in light of the House action and the action that the Senate has taken.

Thank you very much to all of you.

Mr. GUINN. Senator, I think we ought to compliment you for taking time out of your busy schedule. It is a complex issue. It is useful to have a public forum like this to discuss it. From our company, we thank you for giving us the chance.

Senator CANNON. Thank you.

[Whereupon, at 12:12 p.m., the committee was adjourned, to reconvene at the call of the Chair.]

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